RECEIVED
SUPREME COURT
STATE OF WASHINGTON
Oct 20, 2011, 4:45 pm
BY RONALD R. CARPENTER
CLERK

No. 86206-1

RECEIVED BY E-MAIL

SUPREME COURT
OF THE STATE OF WASHINGTON

CERTIFICATION FROM UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON AT SEATTLE
(CASE NO. C09-0149 JCC)

KRISTIN BAIN,

Plaintiff,

v.

MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC., *et al.*,

Defendants.

RESPONSE BRIEF OF DEFENDANT MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC.

Russ Wuehler, WSBA No. 37941
DLA PIPER LLP (US)
701 Fifth Avenue, Suite 7000
Seattle, WA 98104
Phone: 206.893.4800
Fax: 206.839.4801

Robert J. Pratte (*Pro Hac Vice*)
DLA PIPER LLP (US)
90 South Seventh Street, Suite 5100
Minneapolis, MN 55402
Phone: 612.524.3000
Fax: 612.524.3001

Counsel for Defendant Mortgage Electronic Registration Systems, Inc.

ORIGINAL

TABLE OF CONTENTS

Page(s)

I. INTRODUCTION AND RELIEF REQUESTED. 1

II. QUESTIONS CERTIFIED. 3

III. STATEMENT OF FACTS. 4

A. Bain Is A Borrower In Default Who, Through The Underlying Lawsuit, Challenges The Contractual Right To Foreclose. 5

B. MERS And The MERS® System Provide Positive Advantages To Consumers And The Residential Housing Industry. 9

1. The Creation Of MERS And The MERS® System. 9

2. The MERS® System (The Database) Tracks Transfers In Mortgage Loans. 13

3. MERS Serves As A Common Agent In The Land Records. 15

IV. AUTHORITY AND ANALYSIS. 17

A. MERS Is A Proper Beneficiary Under Washington Law. 17

1. MERS Meets The Definition Of "Beneficiary" Under The Deed Of Trust Act. 18

2. Under Washington Law, The Parties Were Free To Contractually Agree That MERS Is A Proper Beneficiary Under The Deed Of Trust, Which Is Exactly What The Parties Did. 24

3. What The Parties Contractually Agreed To – *i.e.*, That MERS Is A Proper Beneficiary – Is Consistent With Basic Principles Of Agency 29

TABLE OF CONTENTS

Page(s)

4. The Courts Repeatedly Find In Favor Of MERS, Striking Down The Very Arguments Plaintiff Asserts Here.....35

B. Even If MERS Was Not A Proper Beneficiary Under The Deed Of Trust Act, That Would Not Have Any Material Effect.....41

C. There Is No Consumer Protection Act Claim Against MERS.....45

1. MERS Has Not Engaged In An Unfair Or Deceptive Act Or Practice.....45

2. The Act Being Challenged Did Not Have The Capacity To Impact A Substantial Portion Of The Public.....46

3. Plaintiff Suffered No Injury Caused By MERS.....48

V. CONCLUSION.....50

APPENDIX.....A-1

TABLE OF AUTHORITIES

Page(s)

CASES

Barkhausen v. Cont'l Ill. Nat'l Bank Trust Co. of Chicago,
120 N.E.2d 649 (Ill. 1954) 32

Brown v. Countrywide Home Loans,
Case No. 09-11481, 2010 WL 1136515 (E.D. Mich. Mar. 24, 2010) 40

Buse v. First American Title Ins. Co.,
Case No. C08-0510MJP, 2009 WL 1543994 (W.D. Wash. 2009) 30

Cebrun v. HSBC Bank,
Case No. C10-5742BHS, 2011 WL 321992 (W.D. Wash. Feb. 2, 2011) 37

Cervantes v. Countrywide Home Loans, Inc.,
--- F.3d ---, 2011 WL 3911031 (9th Cir. Sept. 7, 2011) 27, 28

In re Childs Co.,
163 F.2d 379 (2d Cir. 1947) 32

Coley v. Accredited Home Lenders, Inc.,
Case No. 4:10CV01870 JLH, 2011 WL 1193072 (E.D. Ark. Mar. 29, 2011) 39

Consol. Mortg. & Fin. Corp. v. Landrieu,
493 F. Supp. 1284 (D.D.C. 1980) 33

Cox v. Helenius,
103 Wn.2d 383 (1985) (en banc) 43, 44

In re Cushman Bakery,
526 F.2d 23 (1st Cir. 1975) 31, 32

Daddabbo v. Countrywide Home Loans, Inc.,
Case No. C09-1417RAJ, 2010 WL 2102485 (W.D. Wash. May 20, 2010) 35, 36, 37

TABLE OF AUTHORITIES

Page(s)

Deerman v. Fed. Home Loan Mortg. Corp.,
955 F. Supp. 1393 (N.D. Ala. 1997) 14

Fidelity & Deposit Co. of Maryland v. Ticor Title Ins. Co.,
88 Wn. App. 64 (1997) 39, 40

Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles,
148 Wn.2d 224 (2002) ..... *passim*

Gomes v. Countrywide Home Loan, Inc.,
192 Cal. App. 4th 1149 (2011) 37

Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.,
86 Wn. App. 732 (1997) 47

Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.,
105 Wn.2d 778 (1986) 45, 46, 47

Hashop v. Fed. Home Loan Mortg. Corp.,
171 F.R.D. 208 (N.D. Ill. 1997) 9

Henery v. Robinson,
67 Wn. App. 277 (1992) 47

Horvath v. Bank of N.Y., N.A.,
641 F.3d 617 (4th Cir. 2011) ..... *passim*

Indoor Billboard v. Integra Telecom,
162 Wn.2d 59 (2007) 48

Jackson v. Mortg. Elec. Registration Sys., Inc.,
770 N.W.2d 487 (Minn. 2009) 2

Johnson v. Cash Store,
116 Wn. App. 833 (2003) 49

Klinger v. Wells Fargo Bank,
Case No. C10-05546RJB, 2010 WL 5138478 (W.D. Wash. Dec. 9, 2010) 37

TABLE OF AUTHORITIES

Page(s)

Kucheynik v. Mortg. Elec. Registration Sys., Inc.,
Case No. C10-451Z, 2010 WL 5174540 (W.D. Wash. Dec. 15, 2010) 47, 48

Landmark Nat'l Bank v. Kesler,
289 Kan. 528 (Kan. 2009) 38, 39

M.A. Mortenson Co., Inc. v. Timberline Software Corp.,
140 Wn.2d 568 (2000) (en banc) 25, 27

In re McGrath's Estate
191 Wn. 496, 508 (1937) 24

Michak v. Transnational Title Ins. Co.,
148 Wn.2d 788 (2003) (en banc) 25, 27

Moon v. GMAC Mortg. Corp., et al.,
Case No. C08-969Z, 2009 WL 3185596 (W.D. Wash. Oct. 2, 2009) ..... *passim*

Mortg. Elec. Registration Sys., Inc. v. Nebraska Dep't of Banking & Fin.,
270 Neb. 529 (2005) 37, 38

Mortg. Elec. Registration Sys., Inc. v. Saunders,
2 A.3d 289 (1 st Cir. 2010) 39

Mort. Elec. Registration Sys. Inc. v. Southwest Homes of Arkansas, Inc,
301 S.W. 3d 1 (Ark. 2009) 38, 39

Moss v. Vadman,
77 Wn.2d 396 (1970) (en banc) 30

Nat'l Bank of Wash. v. Equity Investors,
81 Wn.2d 886 (1973) (en banc) 24, 27

Pantoja v. Countrywide Home Loans, Inc.,
640 F. Supp.2d 1177 (N.D. Cal. 2009) 37

TABLE OF AUTHORITIES

Page(s)

Post v. City of Tacoma,
167 Wn.2d 300 (2009) 4

Residential Funding Co., LLC v. Saurman,
--- N.W.2d ---, 2011 WL 1516819 (Mich. App., April 21, 2011) 40, 41

Robbins v. Mortg. Elec. Registration Sys., Inc.,
Case No. C09-295, 2009 WL 3757443 (W.D. Mich. Nov. 9, 2009) 40

Safford v. Precision Funding,
Case No. 09-14925-BC, 2010 WL 548504 (E.D. Mich. Feb. 9, 2010) 40

Salmon v. Bank of America Corp., et al.,
Case No. C10–446RMP, 2011 WL 2174554 (E.D. Wash. May 25, 2011) 37

Saunders v. Lloyd's of London,
113 Wn.2d 330 (1989) 45

Schuh Trading Co. v. Comm'r,
95 F.2d 404 (7th Cir. 1938) 31

Segal Co. (Eastern States), Inc. v. Amazon.com,
280 F. Supp.2d 1229 (W.D. Wash. 2003) 47

Sherman v. Millikin,
9 Wn.2d 339 (1941) 30

Silvas v. GMAC Mortg., LLC,
Case No. CV–09–265–PHX–GMS, 2009 WL 4573234 (D. Ariz. 2009) 37

Simonds v. Noland,
142 Wn. 423, 427 (1927) (en banc) 29

State v. Lively,
130 Wn.2d 1 (1996) (en banc) 31

TABLE OF AUTHORITIES

Page(s)

Torgerson v. One Lincoln Tower, LLC,
166 Wn.2d 510 (2009) 24

In re Tucker,
441 B.R. 638 (W.D. Mo. 2010) 17

Udall v. T.D. Escrow Services, Inc.,
159 Wn.2d 903 (2007) (en banc) 30, 34

Vawter v. Quality Loan Servicing Corp. of Washington,
707 F. Supp.2d 1115 (W.D. Wash. 2010) 36, 37

Walcker v. Benson and McLaughlin,
79 Wn. App. 739 (1995) 39, 40

White v. Homefield Fin., Inc.,
545 F. Supp. 2d 1159 (W.D. Wash. 2008) 47

STATUTES

15 U.S.C. § 1641(f)(2) 15

Kan. Stat. Ann. § 60-219(e) 39

RCW 61.12.020 25

RCW 61.24, *et seq.* ..... *passim*

RCW 62A.3-104 16

RCW 62A.3-203 16

OTHER AUTHORITIES

Arnold, R.K., *Yes, There Is Life On MERS*,
11 PROB. & PROP. 33 (1997) 11, 12, 13

TABLE OF AUTHORITIES

Page(s)

BLACK'S LAW DICTIONARY (7th ed.) 21, 31

H.R. REP. NO. 101-54(I), (1989),
reprinted in 1989 U.S.C.C.A.N. 86 11

History of The U.S. (Fed) Prime Rate from 1947 to the Present,
Wall St. J., http://www.wsjprimerate.us/wall_street_journal_
prime_rate_history.htm 11

Jones, Allen H., Setting the Record Straight on MERS,
MORTG. BANKING 34 (May 2011). ..... *passim*

Friedman, Milton R., Friedman on Contracts & Conveyances of
Real Property, § 6:1:5 *Nominees* 31

Miller, Jeffrey J., *The Effect of the S&L Bailout on Title to Real Property*,
5 PROB. & PROP. 44 (1991) 12

Mozilo, Angelo R., A Century's Milestones in Residential Lending,
MORTG. BANKING 13 (Jan. 2000) 32, 33

Restatement (Third) of Property (Mortgages) § 5.4, cmt. e (1997) 32

Slesinger, Phyllis K. & McLaughlin, Daniel, *Mortgage Electronic Registration System*,
31 Idaho L. Rev. 805 (1995) 10

I. INTRODUCTION AND RELIEF REQUESTED.

This proceeding is before the Court as the result of an Order Certifying Question to the Washington Supreme Court, issued by the Honorable John C. Coughenour of the United States District Court for the Western District of Washington (the "District Court") on June 24, 2011 (the "Certification Order").[1] The Certification Order was issued in two related cases – *Bain v. Metropolitan Mort. Group, Inc., et al.*, Case No. C09-0149 ("*Bain*") and *Selkowitz v. Litton Loan Servicing LP, et al.*, Case No. C10-5523 ("*Selkowitz*"). On October 7, 2011, this Court consolidated *Bain* and *Selkowitz* for purposes of oral argument and decision, but did not consolidate briefing.[2] Mortgage Electronic Registration Systems, Inc. ("MERS") respectfully submits this Response Brief in *Bain*.

Plaintiff Kristin Bain ("Plaintiff" or "Bain") borrowed $193,000 to purchase a home in 2007. Not long after taking out that loan, she defaulted on the loan. Plaintiff has not made a payment on her loan since

---

[1] Case No. C09-0149, Dkt. No. 159. Throughout this brief, references to the record are based upon those documents certified to the Court in the Certification Order, and are cited by Docket Number ("Dkt. No."), with specific references to underlying page numbers.

[2] Although briefing was not consolidated, as the Court has recognized through consolidating argument and decision, the issues in *Bain* and *Selkowitz* are identical. The facts of the two cases vary slightly, but the factual differences are of no consequence. With that said, given both plaintiffs filed an opening brief before consolidation, MERS is filing a separate response brief to each. Although argued slightly differently, both plaintiffs assert essentially the same arguments. As a result, MERS's response briefs, in large part, are similar. In the interests of efficiency, MERS advises the Court that Section III.B. of this brief is identical to Section III.B. of the *Selkowitz* brief.

2008, yet she continues to occupy the property. Facing foreclosure, instead of curing the default on her loan, Plaintiff sued to stop foreclosure. She brought the action against virtually every party that was involved in her loan and the foreclosure process. This included MERS, the party that Plaintiff contractually agreed would be the beneficiary for the lender and its successors and assigns in its capacity as the nominee or agent for the lender under Plaintiff's deed of trust. But Plaintiff now argues that MERS is not a proper beneficiary under her deed of trust, or RCW 61.24, *et seq.*, Washington's Deed of Trust Act (the "Act"). MERS disagrees.

MERS is a Delaware company, headquartered in Reston, Virginia, and a subsidiary of MERSCORP, Inc. ("MERSCORP").[3] The operating company, MERSCORP, also owns the MERS® System, which is a national electronic registry (a database) that tracks beneficial ownership interests and servicing rights in mortgage loans.[4] The MERS® System is operated as a membership organization and, along with MERS, was formed to eliminate problems of delayed releases, reconveyances, and other related title problems that resulted from the collapse of the savings and loan ("S&L") industry in the 1980s.[5] MERS serves as beneficiary of

---

[3] Allen H. Jones, *Setting* the *Record Straight on MERS,* MORTG. BANKING 34, 35 (May 2011).

[4] *Id.*

[5] *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 490 (Minn. 2009).

record (mortgagee in mortgage states) in its capacity as agent for the original lender, its successors and assigns.[6]

Although Bain expressly agreed in her deed of trust that MERS was the beneficiary of record, she now disclaims that contractual agreement and argues MERS is not a proper beneficiary. While many courts, both in Washington and outside of Washington, have simply ruled that MERS is a proper beneficiary and can act on behalf of lenders, through basic agency principles, the District Court here determined that the issue should be certified to this Court for direction.

For the reasons set forth below, MERS respectfully requests that the Court hold that MERS is a lawful "beneficiary" under the Act, even if it never holds the promissory note secured by the deed of trust that it has a legal interest in. In so holding, the Court should further rule that the District Court's remaining certified questions, both of which are posed in the event the Court holds MERS is not a proper beneficiary, are moot.

II. QUESTIONS CERTIFIED.

The District Court certified the following questions to this Court:[7]

---

[6] Jones, supra note 3, at 35.

[7] The certified questions are reproduced here as they are framed in the Certification Order. There appears to be a typographical error, however, in the second of the three certified questions. MERS believes that question should begin by reading "If **not**, what is the legal effect ...."

1. Is Mortgage Electronic Registration Systems, Inc., a lawful "beneficiary" within the terms of Washington's Deed of Trust Act, Revised Code of Washington section 61.24.005(2), if it never held the promissory note secured by the deed of trust?

2. If so, what is the legal effect of Mortgage Electronic Registration Systems, Inc., acting as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

3. Does a homeowner possess a cause of action under Washington's Consumer Protection Act against Mortgage Electronic Registration Systems, Inc., if MERS acts as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

If the answer to the first question is that MERS is a proper beneficiary under the Act, MERS respectfully submits, there is no need to address the second and third questions. The standard of review on these certified questions is *de novo* review.[8]

III. STATEMENT OF FACTS.

The facts that are relevant to the certified questions before the Court in these proceedings are straight-forward.[9]

---

[8] *See Post v. City of Tacoma*, 167 Wn.2d 300, 308 (2009) ("Statutory interpretation is a question of law that this court reviews *de novo*.").

[9] Plaintiff devotes a great deal of her Opening Brief to reciting facts that MERS respectfully submits have no bearing on the issues before the Court. *See* Opening Brief, at 1-3, 7-14 (for example, discussing loan origination lending practices that Plaintiff challenges and various reasons why Plaintiff named certain parties as defendants in the underlying lawsuit that have nothing to do with the certified questions). MERS has no quarrel with how Plaintiff chooses to present her position, but feels it is necessary to note that many of the facts raised by Plaintiff have no bearing on the issues before the Court.

A. Bain Is A Borrower In Default Who, Through The Underlying Lawsuit, Challenges The Contractual Right To Foreclose.

Bain borrowed $193,000 to purchase a home which she promised to repay pursuant to a promissory note dated March 9, 2007 to IndyMac Bank, F.S.B. ("IndyMac") (the "Promissory Note").[10] As part of the transaction, Bain contractually agreed to secure the Promissory Note (*i.e.*, the repayment obligation) with a Deed of Trust, also dated March 9, 2007, that was recorded in the appropriate county land records.[11] The Promissory Note and Deed of Trust go hand-in-hand. This fact was clearly reflected in the Promissory Note and Deed of Trust and contractually agreed to by Bain.[12] Indeed, it could be no other way. Lenders must secure their residential loans to ensure repayment. The way lenders do that is through promissory notes and accompanying deeds of trust – *i.e.*, the very loan documents that were entered into here.

Here, the Deed of Trust specifically names MERS as the beneficiary acting in its capacity as agent for the lender and the lender's

---

[10] Dkt. No. 131-3.

[11] Dkt. No. 131-2.

[12] *See, e.g.*, Dkt. No. 131-2, at 4 of 18 (Deed of Trust) ("This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note."); Dkt. No. 131-3, at 4 of 7 (Promissory Note) ("In addition to the protections given to the Note Holder under this Note, a ... Deed of Trust ... (the "Security Instrument"), dated the same date as this Note, protects the Note Holder

successors and assigns. Specifically, the Deed of Trust provides: "MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. *MERS is the beneficiary under this Security Instrument.*"[13] Bain also granted an interest in the property to MERS in that capacity and authorized MERS to act on the lender's behalf with any foreclosure, discharge or release:

> Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.[14]

Bain also contractually agreed in both the Promissory Note and the Deed of Trust that the lender (IndyMac) could freely and without notice transfer the Promissory Note to another.[15] Finally, Bain irrevocably granted the trustee (Stewart Title) the power of sale in the event of a default.[16]

---

from possible losses that might result if I do not keep the promises that I make in this Note.").

[13] Dkt. No. 131-2, at 2-3 of 18 (emphasis added).

[14] Dkt. No. 131-2, at 4 of 18.

[15] *See* Dkt. No. 131-2, at 12 of 18 (Deed of Trust) ("The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to the Borrower."); Dkt. No. 131-3, at 2 of 7 (Promissory Note) ("I understand that the Lender may transfer this Note.").

[16] Dkt. No. 131-2, at 2 & 4 of 18 ("Borrower irrevocably grants and conveys to Trustee, in trust, with power of sale, the following described property ...").

The Promissory Note and Deed of Trust were signed by Bain and her signature on the Deed of Trust was acknowledged by a notary. The Deed of Trust was duly recorded in the appropriate public land records, providing notice that MERS was the contractually agreed to beneficiary under the Deed of Trust, in its capacity as the agent for the lender.

In 2008, Bain defaulted on her loan. On August 26, 2008, Regional Trustee Services Corporation ("Regional Trustee") – the successor trustee to Stewart Guaranty[17] – issued a Notice of Default to Bain pursuant to RCW 61.24.030.[18] On September 3, 2008, MERS assigned its interest in the Deed of Trust to IndyMac, which assignment was duly recorded on September 9, 2008.[19] On September 25, 2008, Regional Trustee issued and recorded a Notice of Trustee's Sale and Notice of Foreclosure to Bain pursuant to RCW 61.24.040.[20]

To halt the foreclosure sale, in December 2008, Bain filed an action in the Superior Court of the State of Washington in and for King County, seeking injunctive relief and asserting various causes of action

---

17 On August 26, 2008, IndyMac executed an Appointment of Successor Trustee, appointing Regional Trustee as Successor Trustee to Stewart Guaranty under the Deed of Trust, which was recorded on September 9, 2008. *See* Dkt. No. 1, at 42-43 of 67.

18 Dkt. No. 112, at 5 of 13.

19 Dkt. No. 1, at 39-40 of 67.

20 Dkt. No. 112, at 5 of 13.

against a number of defendants.[21] The King County action was removed to the District Court in February 2009 (the "District Court Action").

Through the District Court Action, Bain seeks to avoid foreclosure on her home despite the fact that she remains in default. Furthermore, Bain continues to occupy the property, even though she has not made a payment on the property in over three years. In summary, the incontrovertible material facts are as follows:

- Bain defaulted on her Promissory Note in 2008 and has not cured, yet Bain continues to occupy the property for free.
- Bain contractually agreed that the Deed of Trust secures repayment of the Promissory Note and authorizes the foreclosure sale of the property in the event of default.
- Through the Deed of Trust, Bain contractually agreed that MERS was the "beneficiary" acting as the agent for the original lender, IndyMac, and its successors and assigns.
- Bain contractually agreed that MERS had the right to foreclose on behalf of the lender as the agent for the lender (and its successors and assigns).
- On August 26, 2008, IndyMac appointed Regional Trustee as the successor trustee to Stewart Guaranty, and Regional Trustee issued a Notice of Default to Bain.
- On September 3, 2008, MERS assigned its beneficial interest in the Deed of Trust back to IndyMac.
- Still not having cured the default, on September 25, 2008, Regional Trustee issued to Bain and recorded a Notice of Trustee's Sale and Notice of Foreclosure.

---

[21] Dkt. No. 1.

Based upon these incontrovertible facts, there is no basis to further delay foreclosure. The foreclosure avoidance arguments Bain advances are without merit; they are not supported by the facts or the law.

B. MERS And The MERS® System Provide Positive Advantages To Consumers And The Residential Housing Industry.

The issues before the Court in these proceedings must be considered in proper context. Central to that context is a foundational understanding of MERS and the MERS® System, and the advantages to consumers and the residential housing industry that they provide.

1. The Creation Of MERS And The MERS® System.

The real estate finance industry includes primary and secondary mortgage markets for residential, multifamily, and commercial properties. In the primary residential mortgage market, lenders make loans to consumers so they can buy or refinance homes.[22] In the secondary market, mortgage loans are sold, providing new funds to lenders to facilitate making new loans. Secondary market purchasers often bundle loans into mortgage-backed securities that are sold to third-party investors, who then have beneficial interests in the underlying mortgage debt.[23]

---

22 *Hashop v. Fed. Home Loan Mortg. Corp.*, 171 F.R.D. 208, 210 (N.D. Ill. 1997).

23 *Id.*

Before MERS and the MERS® System, when an interest in a mortgage loan was transferred, the parties would often, but not always, change the mortgagee by recording an assignment of the security instrument in the land records.[24] Loans were frequently originated in the name of one lender and then transferred to aggregators, who might transfer servicing to still another party. In most cases, an assignment was recorded so that the purchaser or servicer would appear in the land records[25] and receive service of process and other legal notices. To complicate matters further, when the servicing remained with the seller, the seller often remained the mortgagee of record. And if servicing changed hands, the land records were updated only if the new servicer wanted to receive service of process.[26] This process could take a long time to complete—up to six months for a modest loan portfolio. County recorder offices struggled to manage the volume of filings, which threatened the integrity of the land title recordation system and jeopardized the ability of consumers to obtain residential mortgage loans. Error rates as high as

---

[24] Jones, *supra* note 3, at 36.

[25] Phyllis K. Slesinger & Daniel McLaughlin, *Mortgage Electronic Registration System*, 31 IDAHO L. REV. 805, 809 (1995).

[26] Jones, *supra* note 3, at 36.

33% were common, with assignments recorded in the wrong sequence or missing altogether—clouding title to properties.[27]

Additionally, the S&L crisis contributed to the title problems faced by the industry, which included difficulties in obtaining assignments, satisfactions, and reconveyances from collapsed S&Ls. For example, in the 1970s and 1980s, dramatic fluctuations in the prime rate occurred, with a low of 4.5% in the 1970s and a record high of 21.50% in the early 1980s.[28] With the prime rate above 15% for many years during the 1980s, the ability of people to qualify for residential mortgage loans plummeted, and the value of homes and the volume of sales either stagnated or dropped significantly.[29] By the mid-1980s, the S&L industry, which originated half of all mortgage loans nationwide, collapsed.[30] At about this time, the prime rate dropped precipitously to below 8%,[31] and with the drop, high-interest rate homeowners attempted to refinance.

---

[27] R.K. Arnold, *Yes, There Is Life On MERS*, 11 PROB. & PROP. 33, 34 (1997); Jones, *supra* note 3, at 36.

[28] *See History of The U.S. (Fed) Prime Rate from 1947 to the Present*, WALL ST. J., http://www.wsjprimerate.us/wall_street_journal_ prime_rate_history.htm (last visited Sept. 2, 2011).

[29] H.R. REP. NO. 101-54(I), at 296 (1989), reprinted in 1989 U.S.C.C.A.N. 86, 92 ("Double digit mortgage rates and inflation made people shy away from home purchases. Housing starts in 1981 and 1982 dropped to their lowest level in over 20 years.").

[30] *Id.* at 291, 1989 U.S.C.C.A.N. at 87.

[31] *See History of The U.S. (Fed) Prime Rate from 1947 to the Present*, WALL ST. J., http://www.wsjprimerate.us/wall_street_journal_ prime_rate_history.htm (last visited September 2, 2011).

To refinance a residential mortgage loan, payoff information is needed and appropriate satisfactions and releases of mortgages or reconveyances of deeds of trust must be recorded so that the new lender can take a first lien on the property. One of the most significant consequences of the S&L crisis was that homeowners and title insurance companies were unable to get timely releases of their mortgages.[32] With the mortgage refinance boom in the 1990s, there was a severe backlog of paperwork in county land record offices, which also delayed lien releases and related home purchase and mortgage refinance transactions to the detriment of consumers attempting to benefit from falling interest rates. It soon became readily apparent that the mortgage recordation system, which had been in use for nearly 400 years, could not keep up.

Leading participants in the real estate finance industry, including the Mortgage Bankers Association ("MBA"), became concerned about these problems and the challenges posed by the increased volume of mortgage loans, servicing transfers, and mortgage loan portfolio transactions. In 1993, these entities therefore proposed developing an improved system for tracking interests in mortgage loans, much like the

---

[32] *See, e.g.*, Jeffrey J. Miller, *The Effect of the S&L Bailout on Title to Real Property*, 5 PROB. & PROP. 44, 47-49 (1991) (discussing various title-related issues faced by the takeover of certain S&Ls in the 1980s); Arnold, *supra* note 27, at 34 (explaining issues of title and delays).

security industry's book-entry system successfully used by the Depository Trust Company since the 1970s.[33] The mortgage recordation backlog was similar to Wall Street's "paperwork crisis" of the late 1960s, with clerks buried in paper stock certificates that could not be processed quickly enough. To resolve this crisis, Wall Street turned to technology and a system of book-entry accounting to track stock ownership. Mortgage companies, banks, investors, and governmental officials saw the success of this new book-entry system and explored options to track unrecordable interests in mortgage loans. Out of these discussions emerged MERS.

2. The MERS® System (The Database) Tracks Transfers In Mortgage Loans.

The MERS® System, which is a database owned and operated by MERSCORP, tracks transfers of servicing rights and beneficial ownership interests in mortgage loans[34] by using a permanent 18-digit number called the Mortgage Identification Number. The data tracked in the MERS® System is provided by its members—mortgage lending and servicing institutions.[35] MERS® System members have a substantial interest in providing accurate and up-to-date information because MERS® System members (and the public) rely on it to obtain current information about

---

33 Arnold, *supra* note 27, at 33-35; Jones, *supra* note 3, at 36.

34 Jones, *supra* note 3, at 35.

35 *Id.* at 36.

note owners and servicers, as well as to obtain all legal notices regarding the property, which are served on MERS.[36]

The MERS® System tracks changes in servicing rights among its members. The servicer services the loan for the ultimate investor, the beneficial owner(s) of the promissory note. Servicers receive and process loan payments and payoffs; deal with tax and insurance escrows; handle delinquencies, forebearances, and modifications; and interact with borrowers.[37] Knowing the identity of the servicer—not the investor who typically does not interact with a borrower—is what is most essential because the servicer handles the day-to-day servicing responsibilities, just as it did before the advent of the MERS® System.[38]

The MERS® System thus fills an information void that county recorders have never provided—the identity of the current servicer and investor of the mortgage loan. Borrowers can locate this information by calling the toll-free number listed on every MERS deed of trust or by accessing the MERSCORP website, www.mersinc.org. And although the disclosure of the note owner is optional, 97% of the over 3,000 MERS® System members disclose their identity. Further, a borrower may request

---

[36] *Id.* at 38.

[37] *See, e.g., Deerman v. Fed. Home Loan Mortg. Corp.*, 955 F. Supp. 1393, 1396 (N.D. Ala. 1997).

[38] Jones, *supra* note 3, at 38.

the identity of the investor from the servicer pursuant to the Truth in Lending Act.[39] It is this current and easily accessible information on the MERS® System that enables title insurers, lenders, municipal governments, state and federal agencies, and consumers to ascertain the owners of vacant and abandoned properties; combat mortgage fraud; identify parties for service of process; and arrange for consolidations, loan modifications, payoff statements, deeds in lieu of foreclosure, short sales, and releases.

3. MERS Serves As A Common Agent In The Land Records.

MERS serves as the beneficiary in deed of trust states like Washington (mortgagee of record in mortgage states) which are the security agreements securing the promissory notes that evidence the debt.[40] MERS' role as beneficiary of record is fully disclosed, agreed to by borrowers, established in the security agreements, and duly recorded in county land records.

In Washington, MERS becomes the beneficiary of record by being named by the borrower and the lender as beneficiary in the deed of trust, in a representative capacity as the nominee or agent for the lender, when the loan is originated. Once designated the beneficiary in the deed of

---

39 15 U.S.C. § 1641(f)(2).

40 Jones, *supra* note 3, at 35.

trust, MERS remains the beneficiary on behalf of the lender when ownership interests in the note or servicing rights to the loan are sold.[41] Those transactions *do not occur* through the MERS® System—they occur outside of it—but they are electronically tracked in the MERS® System. At all times, the deed of trust designating MERS as the beneficiary is recorded in the public land records, keeping the world on record notice of the security interest in the property, as well as MERS' role as beneficiary and disclosed agent for the lender, its successors and assigns.[42]

Beneficial ownership interests in the accompanying loan (the promissory note) are sold by endorsement and delivery of the note under the Uniform Commercial Code ("UCC").[43] The note is the negotiable, intangible asset that provides value to financial institutions and investors.[44] Like other promissory notes, the right to receive loan payments is legally transferred when one holder negotiates the note to another by endorsement and delivery.[45] When a lender transfers its interest in the note, MERS retains its obligations to the lender, its successors and assigns through an

---

41 *Id.* at 36.

42 *Id.* at 36, 38.

43 *See, e.g.*, RCW 62A.3-203–62A.3-206.

44 RCW 62A.3-104.

45 RCW 62A.3-203. *See also Horvath v. Bank of N.Y., N.A.*, 641 F.3d 617, 621 (4th Cir. 2011).

agency relationship,[46] which is authorized under the deed of trust itself and affirmed by MERS® System members in their membership agreements.[47]

Using MERS as the beneficiary of record, acting in an agency capacity for the lender, therefore provides positive advantages. MERS reduces the possibility of missed or incorrect assignments creating unclear title. When MERS serves as beneficiary, the recorded chain of title starts with MERS at origination and ends with MERS when it either releases the lien or assigns the lien to another entity. MERS also streamlines the lien release process, reducing research time and processing fees. MERS thus assists in better and more economically serving a greater number of people by increasing efficiencies and accuracy in the housing industry.[48]

IV. AUTHORITY AND ANALYSIS.

A. MERS Is A Proper Beneficiary Under Washington Law.

Bain's argument that MERS is not a proper "beneficiary" boils down to the contention that MERS was never the holder of the Promissory Note.[49] This argument fails for a number of reasons.

---

[46] *See In re Tucker,* 441 B.R. 638, 646 (W.D. Mo. 2010) (recognizing the agency relationship between MERS, as mortgagee, and its members).

[47] All MERS membership documents are publicly available on the MERS website, www.mersinc.org.

[48] Jones, *supra* note 3, at 36, 38.

[49] Opening Brief, at 18 ("Since MERS is never the holder of the promissory note, it cannot be the 'beneficiary' under Washington state law.").

1. MERS Meets The Definition Of "Beneficiary" Under The Deed Of Trust Act.

First and foremost, MERS was a proper "beneficiary" under the Deed of Trust, as a matter of law, because it meets the statutory definition of "beneficiary" set forth in the Act.

Bain asks the Court to interpret the definition of "beneficiary" under the Act in a manner that is far narrower than it should be interpreted. Bain argues that "beneficiary" *solely* means the holder of the Promissory Note.[50] The Court should reject that strained reading.

"In interpreting a statute, the primary objective of the court is to ascertain and carry out the intent and purpose of the Legislature in creating it."[51] "To determine legislative intent, this court looks first to the language of the statute."[52] "Legislative definitions provided in a statute are controlling, but in the absence of a statutory definition, courts may give a term its plain and ordinary meaning by reference to a standard dictionary."[53] The Court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences."[54]

---

50 *Id.*

51 *Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 239 (2002) ("*Tenino Aerie*").

52 *Id.*

53 *Id.*

54 *Id.* ("spirit or purpose of an enactment should prevail over ... inept wording").

The statutory provision at-issue here is found at RCW 61.24.005 – *i.e.*, the definition of "beneficiary" under the Deed of Trust Act. It reads:

> The definitions in this section apply throughout this chapter *unless the context clearly requires otherwise....*
>
> (2) "Beneficiary" means the holder of the *instrument* or *document* evidencing *the obligation* secured by the deed of trust.[55]

MERS meets this definition for, at least, the following reasons:

First, the Washington Legislature specifically indicated that the term "beneficiary" had the meaning provided "*unless the context clearly requires otherwise.*"[56] The Legislature did not have to include this qualifying language. But it did. And because it did, the Legislature clearly recognized and intended that there may be circumstances where a rigid reading of the defined terms in the Act would be inappropriate. This is one of those circumstances. The Court must give the Legislature's caveat meaning, and look at the full context here.[57]

The context here *requires* that MERS be recognized as a proper "beneficiary" under the Deed of Trust. The context here is that the Legislature was creating a more efficient default remedy for lenders, not putting up barriers to foreclosure. The Deed of Trust Act was also enacted

---

55 RCW 61.24.005 (emphasis added).

56 *Id.* (emphasis added).

57 *Tenino Aerie*, 148 Wn.2d at 239.

within the context of Washington law, which specifically permits the use of agents and the right to freely contract.[58] In that context, by including MERS in the transaction, the parties agreed that, instead of a traditional three party deed of trust, it would be a four party deed of trust, wherein MERS would act as the contractually agreed upon beneficiary for the lender and its successors and assigns. Bain has pointed to no statute or public policy that prohibits the parties from so contracting; to the contrary, the parties were legally entitled to do so.[59] *Simply put, the parties contractually agreed that the "beneficiary" under the Deed of Trust was "MERS"* and it is in that context that the Court should apply the statute.[60]

Second, MERS meets the definition of "beneficiary" set forth in the Act on its face. The Act does not define "beneficiary" as "the holder of the note," which is the definition Plaintiff asks the Court to adopt. The statutory definition is broader. If the Washington Legislature intended "beneficiary" to solely mean "the holder of the *note*," it would have defined it that way. The fact that it did not evidences the Legislature's intent that "beneficiary" means more than just the holder of the note, and the Court should give effect to that Legislative intent.

---

58 *See*, *infra* Sections IV.A.2. & IV.A.3.

59 *Id.*

60 Dkt. No. 131-2, at 2-3 of 18 ("MERS is the beneficiary under this Security Instrument.").

The Legislature broadly defined "beneficiary" to mean "the holder of the *instrument or document* evidencing the *obligations* secured by the deed of trust."[61] "Instrument," "document" and "obligations" are not defined and should be given their plain and ordinary meaning.[62]

> "Instrument" broadly means: "A written legal document that defines rights, duties, entitlements, or liabilities, such as a contract, will, promissory note, or share certificate."[63]
>
> "Document" is even broader, meaning: "Something tangible on which words, symbols, or marks are recorded." Alternatively, "The deeds, agreements, title papers, letters, receipts, and other written instruments used to prove a fact."[64]

Neither "instrument" nor "document," under any reasonable constructions can be read to solely mean "promissory note." The Legislature clearly intended more. And in the context of a residential loan, undoubtedly the Legislature was referring to all of the loan documents that make up the loan transaction – *i.e.*, the note, the deed of trust, and any other rider or document that sets forth the rights and obligations of the parties under the loan.

> "Obligations" broadly means: "A legal or moral duty to do or not do something."[65]

---

61 RCW 61.24.005(2).

62 *Tenino Aerie*, 148 Wn.2d at 239.

63 BLACK'S LAW DICTIONARY 801 (7th ed.).

64 BLACK'S LAW DICTIONARY 498 (7th ed.).

65 BLACK'S LAW DICTIONARY 1102 (7th ed.).

Thus, "obligation" means more than just repayment of the debt under the Promissory Note as Plaintiff contends. It includes any and all obligations owed by Plaintiff under the Promissory Note and the Deed of Trust.

The Deed of Trust defines the obligation – the "loan" – as "the debt evidenced by the Note, plus interest, any prejudgment charges and late charges due under the Note, *and all sums due under this Security Interest,* plus interest."[66] "Obligations" under the Act, therefore, include all "taxes, assessments, charges, fines, and impositions ..., leasehold payments or ground rents ..., Community Association Dues, Fees, and Assessments," insurance costs, costs to maintain the property, and any attorneys' fees and costs incurred in the event of default.[67] These additional loan "*obligations*" are part of and accrue under the Deed of Trust, *not the Promissory Note*.[68] Simply put, the "obligations" owed by Plaintiff arise under *both* the Promissory Note *and* the Deed of Trust (not just the Promissory Note).[69] MERS is indisputably the "holder" of the Deed of Trust. MERS is, therefore, a proper "beneficiary" under the Deed

---

66 Dkt. No. 131-2, at 3 of 18.

67 Dkt. No. 131-2, at 6-11 of 18.

68 Dkt. No. 131-2, at 4 of 18.

69 Plaintiff claims that "MERS' own documents" show that MERS has no relationship with the lender or the loan, except through its electronic database. Opening Brief, at 17. This statement is false and not supported by the referenced documents.

of Trust as that term is defined by the Deed of Trust Act.[70]

This analysis is underscored by logic. The interpretation of "beneficiary" that Plaintiff is asking the Court to adopt is one that is simply not palatable, and certainly not one that the Legislature intended when it enacted the Act. The Promissory Note and the Deed of Trust were entered into contemporaneously as one loan transaction. They set forth all of the rights and obligations of the parties (in unequivocal terms). The Legislature certainly did not intend to disregard many of those rights and obligations (*i.e.*, the ones that are set forth in the Deed of Trust) through the Act. More to the point, the Legislature certainly did not intend for home loans in the State of Washington to become unsecured, or to allow defaulting home loan borrowers to avoid non-judicial foreclosure, through manipulation of the defined terms in the Act.[71] But that is precisely what Plaintiff is asking this Court to rule.[72]

---

[70] Plaintiff encourages the Court to define "beneficiary" consistent with the UCC. Opening Brief, at 20-21. First, it is troubling that, on one hand, Plaintiff asks the Court to strictly apply the Deed of Trust Act's definition of "beneficiary" (*see* Opening Brief, at 12, 41), then, on the other hand, asks the Court to reframe that definition consistent with her liking. But Plaintiff's inability to commit to a position is of no consequence. Regardless of whether the Act's definition of "beneficiary" is strictly applied or if it is reframed consistent with the UCC, for the reasons discussed throughout this brief, MERS is a proper beneficiary under the Deed of Trust.

[71] *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

[72] Plaintiff devotes a significant portion of her Opening Brief to discussing the Legislature's treatment of and amendments to the Act. Opening Brief, at 26-33. This discussion is designed to suggest that the Legislature's intent is that MERS cannot be a

2. Under Washington Law, The Parties Were Free To Contractually Agree That MERS Is A Proper Beneficiary Under The Deed Of Trust, Which Is Exactly What The Parties Did.

Bain's argument also fails, because it is squarely contrary to what Bain legally and contractually agreed to. The Deed of Trust is a contract that Bain entered into to secure repayment under the Promissory Note.[73] It is black letter law that, absent an unlawful purpose, parties in Washington are free to contract as they wish. As this Court has plainly and consistently stated, "[t]he whole panoply of contract law rests on the principle that one is bound by the contract which he voluntarily and knowingly signs."[74] Indeed, these bedrock principles of contract law are so firm that this Court has gone even further, ruling: "a party to a contract

---

"beneficiary" under a deed of trust. The suggestion is unavailing. First, Plaintiff does not (and cannot) point to any Legislative intent that lenders cannot appoint agents to act on their behalf under the Act (even as a beneficiary), nor is there any evidence that the Legislature intended that parties cannot contractually agree to deed of trust beneficiary status, as the parties did here. Second, as Plaintiff notes, the Legislature amended the Act in 2009, well after the issue of MERS's propriety as a beneficiary in deeds of trust was being raised in courts throughout the State. If the Legislature wanted to declare MERS (as the contractually agreed agent for the lender) is an invalid beneficiary under the Act, the Legislature very easily and publicly could have done that in 2009. It has not.

[73] *In re McGrath's Estate*, 191 Wn. 496, 508 (1937) ("trust deeds are contracts").

[74] *Nat'l Bank of Wash. v. Equity Investors*, 81 Wn.2d 886, 912-13 (1973) (en banc); *see also Torgerson v. One Lincoln Tower, LLC*, 166 Wn.2d 510, 517 (2009) ("It is black letter law of contracts that the parties to a contract shall be bound by its terms.").

which he has voluntarily signed *will not be heard* to declare that he did not read it, or was ignorant of its contents."[75]

The Deed of Trust Act itself invokes these fundamental contract principles. Pursuant to the Act, deeds of trust are subject to all laws relating to mortgages on real property.[76] One such law is codified at RCW 61.12.020, which expressly provides, "parties may insert in [a] mortgage *any lawful agreement or condition.*"[77] Thus, pursuant to the Deed of Trust Act itself, the parties were free to include any lawful contractual agreement or condition in the Deed of Trust. These contract rules, without more, end the analysis.

First, in the Promissory Note, **Bain contractually agreed that the accompanying Deed of Trust went hand-in-hand with the Promissory Note and agreed to be bound by the terms of the Deed of Trust.**[78] Specifically, in the Promissory Note, Bain unequivocally agreed: "*In addition* to the protections given to the Note Holder under this Note, a ...

---

[75] *Michak v. Transnational Title Ins. Co.*, 148 Wn.2d 788, 799 (2003) (en banc) (emphasis added; internal citations omitted); *see also M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 140 Wn.2d 568, 584 (2000) (en banc) ("it was not necessary for [plaintiff] to actually read the agreement in order to be bound by it").

[76] RCW 61.24.040.

[77] RCW 61.12.020 (emphasis added).

[78] This agreement was not out of the ordinary. To the contrary, courts have long-recognized that notes and deeds of trust are conjoined instruments. *See Horvath v. Bank of N.Y., N.A.*, 641 F.3d 617, 624 (4th Cir. 2011) ("it is equally clear that 'notes and contemporaneous written agreements executed as part of the *same transaction* will be construed together as forming one contract.'" (emphasis in original)).

Security Deed (the 'Security Instrument'), dated the same date as this Note, protects the Note Holder from possible losses that might result if I do not keep the promises that I make in this Note."[79]

Second, in the Deed of Trust, **Bain contractually agreed that MERS was a proper beneficiary under the Deed of Trust, authorized to act as the agent of the lender and the lenders successors and assigns**. Specifically, in the Deed of Trust, Bain unequivocally agreed: "*The beneficiary of this Security Instrument is MERS (solely as nominee for Lender and Lender's successors and assigns)* and the successors and assigns of MERS. *This Security Instrument secures to Lender*: (i) the repayment of the Loan ...; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note."[80] Bain further agreed, "*MERS . . . has the right*: to exercise any or all [legal rights of the Lender], including, but not limited to, the right to foreclose and sell the Property; and *to take any action required of Lender* including, but not limited to, releasing and cancelling this Security Instrument."[81]

It is indisputable that Bain contractually agreed that MERS could act on behalf of the lender (IndyMac) and its successors and assigns as the beneficiary under the Deed of Trust. It is further indisputable that Bain

---

79 Dkt. No. 131-3, at 4 of 7 (emphasis added).
80 Dkt. No. 131-2, at 4 of 18 (emphasis added).
81 Dkt. No. 131-2, at 4 of 8 (emphasis added).

contractually agreed that MERS was a valid beneficiary under the Deed of Trust, with all of the powers bestowed upon it through the Deed of Trust to act on behalf of IndyMac (and its successors and assigns). Under this Court's unwavering pronouncements on Washington contract law, Bain should not now be heard to argue that MERS was not a proper beneficiary, with full authority to act on behalf of IndyMac, under the Deed of Trust.[82]

The Ninth Circuit recently conducted this very same analysis (applying similar Arizona law) and came to the same conclusion.[83] In *Cervantes*, plaintiffs asserted a claim for fraud, among other things, arguing that "MERS is a 'sham' beneficiary without a financial interest in the loan ...."[84] While styled as a fraud claim, this is essentially the identical argument Bain makes here – *i.e.*, that MERS is not a proper "beneficiary" because MERS was not entitled to payments under the note. In rejecting the argument, the Ninth Circuit expressly noted:

> [Plaintiffs'] claim is undercut by the terms in [plaintiffs'] standard deed of trust, which describe MERS's role in the home loan.... [T]he disclosures in the deed indicate that MERS is acting 'solely as a nominee for Lender and Lender's successors and assigns' and holds 'only legal title to the interest granted by Borrower in this Security Instrument.' Further, while plaintiffs indicate that MERS was used to hide

---

82 *Michak*, 148 Wn.2d at 799; *M.A. Mortenson Co., Inc.*, 140 Wn.2d at 584; *Nat'l Bank of Wash.*, 81 Wn.2d at 912-13.

83 *See Cervantes v. Countrywide Home Loans, Inc.*, --- F.3d ---, 2011 WL 3911031 (9th Cir. Sept. 7, 2011).

84 *Id.* at *5.

> who owned the loan, the deed states that the loan or a partial interest in it 'can be sold one or more times without prior notice to Borrower,' but that '[i]f there is a change in Loan Servicing, Borrower will be given written notice of the change' as required by consumer protection laws. Finally, the deed indicates that MERS has 'the right to foreclose and sell the property.' *By signing the deeds of trust, the plaintiffs agreed to the terms and were on notice of the contents....* In light of the explicit terms of the standard deed signed by [plaintiffs], it does not appear that the plaintiffs were misinformed about MERS's role in their home loans.[85]

The Fourth Circuit also very recently rejected the same arguments Plaintiff makes here. In *Horvath v. Bank of New York, N.A.*,[86] plaintiff sought to quiet title on his property, in part on the theory that his deed of trust was separated from his note, and that the parties could not have properly contractually agreed that MERS was a valid beneficiary under the deed of trust.[87] The Fourth Circuit outright rejected the argument:

> [Plaintiff's] argument is seriously flawed. For starters, both the deed of trust and the case law suggest that there is no reason to treat the note and deed of trust as governed by separate forms of law. The text of the deed of trust envisions that it will be conjoined with the note, clarifying that '[t]he Note or a partial interest in the Note (*together with this Security Instrument*) can be sold one or more times without prior notice to Borrower.' ... This provision belies any contention that the note is somehow walled off from the deed of trust. ...
>
> Here, that 'agreement' is that the note and deed of trust form part of one transaction, that the note may be transferred freely

---

85 *Id.* (internal citation omitted; emphasis added).

86 641 F.3d 617 (4th Cir., 2011).

87 *Id.* at 623.

> with the purchaser or recipient inheriting full rights to enforce, and that the deed of trust follows the note.
>
> Indeed, common sense suggests that things could not be any other way. If [plaintiff] were correct in asserting that the transfer of a note splits it from the deed of trust ..., there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, but on [plaintiff's] view, transferring a note would strip it from the security that gives it value and render the note largely worthless. This cannot be – and is not – the law.[88]

The Ninth and the Fourth Circuits could not have said it more eloquently. Having entered into a lawful contract whereby the parties agreed that MERS would act as an agent for IndyMac (and its successors and assigns) as the "beneficiary" under the Deed of Trust, Bain cannot now complain that MERS was not a proper beneficiary.[89] To rule otherwise would require the unraveling of decades-old contract jurisprudence by this Court.

3. What The Parties Contractually Agreed To – *i.e.*, That MERS Is A Proper Beneficiary – Is Consistent With Basic Principles Of Agency.

What Plaintiff appears to be arguing, in addition to her argument that she should not be bound by the terms of her contract, is that IndyMac could not act through an agent (MERS).[90] This argument plainly fails.

---

[88] *Id.* at 623-24 (emphasis in original; citations omitted).

[89] *Simonds v. Noland*, 142 Wn. 423, 427 (1927) (en banc) (where agreement is found to be legally valid, contracting party is estopped from denying its terms).

[90] *See* Opening Brief, at 18 ("[A] foreclosure can only occur when the holder of the promissory note has determined that the borrower has breached the promissory note. Since MERS is never the holder of the promissory note, it cannot be the 'beneficiary' under Washington state law.").

The use of "nominees" or "agents" acting on one's behalf is not against public policy, but instead has long been recognized under Washington law. Indeed, as this Court has instructed, "whatever one may lawfully do for himself, he may lawfully authorize an agent to do for him."[91] "[A]n agency relationship results from the manifestation of consent by one person that another shall act on his behalf and subject to his control, with a correlative manifestation of consent by the other party to act on his behalf and subject to his control."[92] Here, the manifestation of consent to an agency relationship between MERS and IndyMac was not only contractually agreed to by MERS and IndyMac, but it was contractually agreed to by Bain.[93]

Furthermore, not only are agency principles a long-standing facet of Washington common law, but the Deed of Trust Act itself expressly contemplates the use of agents. For example, RCW 61.24.031 repeatedly recognizes that acts may be performed under the Deed of Trust Act by an "authorized agent."[94] Specifically, without limitation, the Act permits

---

91 *Sherman v. Millikin*, 9 Wn.2d 339, 341 (1941).

92 *Moss v. Vadman*, 77 Wn.2d 396, 402-403 (1970) (en banc).

93 *See* Dkt. No. 131-2, at 2-4 of 18.

94 RCW 61.24.031. This Court has previously recognized that the Deed of Trust Act permits the use of agents. *See, e.g., Udall v. T.D. Escrow Services, Inc.*, 159 Wn.2d 903, 914-15 (2007) (en banc) (upholding use of agent in Deed of Trust Act foreclosure); *see also Buse v. First American Title Ins. Co.*, 2009 WL 1543994, *2 (W.D. Wash. 2009) ("The Deed of Trust Act 'explicitly permits trustees to use agents, thereby incorporating agency law principles.'" (citations omitted)).

agents to issue notices of default,[95] contact borrowers to assess borrower's financial ability to pay to avoid foreclosure,[96] advise borrowers of their meeting rights relating to foreclosure,[97] participate in any such meeting,[98] and more.[99] In enacting the Act, the Washington Legislature plainly intended to permit participants in transactions governed by the Act to act through agents.[100] That is all that happened here.

Indeed, the use of a nominee, which simply means "one designated to act for another as his representative in a rather limited sense,"[101] is a common occurrence and "has long been sanctioned as a legitimate practice."[102] Individuals frequently confer rights on a "nominee" or "agent" for a variety of purposes, including executing or holding security

---

95 RCW 61.24.031(1)(a).

96 RCW 61.24.031(1)(b).

97 RCW 61.24.031(1)(c).

98 RCW 61.24.031(3).

99 RCW 61.24.031.

100 When there is no legislative intent to overturn the common law, it is presumed that legislation is consistent with existing common law. *State v. Lively*, 130 Wn.2d 1, 11 (1996) (en banc) ("If the statute ... provides no indication of the Legislature's intent to overrule common law, the statute will be presumed to follow judicial precedent.").

101 *Schuh Trading Co. v. Comm'r*, 95 F.2d 404, 411 (7th Cir. 1938); *see also* BLACK'S LAW DICTIONARY 1072 (7th ed.) (A "nominee" is "[a] person designated to act in place of another, usually in a very limited way.").

102 *In re Cushman Bakery*, 526 F.2d 23, 30 (1st Cir. 1975) (citations omitted); *see also* MILTON R. FRIEDMAN, FRIEDMAN ON CONTRACTS & CONVEYANCES OF REAL PROPERTY, § 6:1:5 *Nominees* ("it is familiar practice in real estate transactions to use a nominee").

instruments.[103] The RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) confirms that an agent may be used to enforce a deed of trust on behalf of a note owner, even instructing courts to "be vigorous in seeking to find such [an agency] relationship, since the result is otherwise likely to be a windfall for the mortgagor and the frustration of [the note owner's] expectation of security."[104] Further, there is simply nothing disadvantageous to consumers through the use of agents in mortgage lending practices. To the contrary, as discussed above, it allows for more efficient lending and loan servicing. In short, using a nominee or agent to serve as mortgagee is nothing new, and in fact, was part of the lending system decades before MERS and the MERS® System came into existence.

For example, under the Federal Housing Administration's ("FHA") insured loan program in the 1930s, mortgage lenders originated mortgage loans and sold them to investors, such as life insurance companies.[105] The originating lenders, as independent contractors, serviced the loans as mortgagee of record on behalf of the investors, the beneficial owners

---

[103] *In re Cushman Bakery*, 526 F.2d at 30; *In re Childs Co.*, 163 F.2d 379, 382 (2d Cir. 1947); *Barkhausen v. Cont'l Ill. Nat'l Bank Trust Co. of Chicago*, 120 N.E.2d 649, 655 (Ill. 1954).

[104] RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.4, cmt. e (1997).

[105] *See, e.g.*, Angelo R. Mozilo, *A Century's Milestones in Residential Lending*, MORTG. BANKING 13, 13-14 (Jan. 2000) (describing historical context and the creation of the FHA).

whose names did not appear in the county land records. Before securitization in the 1960s, it was also common that two or more thrifts would buy a group of mortgage loans and obtain participation interests in them. These participation loans were often serviced by one lender, as mortgagee of record, that retained no beneficial interest in the participation loan or the underlying loans themselves.[106] Later, with the advent of securitization in the late 1960s and early 1970s,[107] Ginnie Mae, under its guarantee agreement, became the equitable owner of pooled loans while the originator or aggregator of the loans, the "issuer," either remained or became the mortgagee of record and serviced the loan as an independent contractor.[108] Fannie Mae and Freddie Mac soon followed, utilizing the same model.[109] Thus, the use of an agent to hold legal title in a mortgage while another holds a beneficial interest in the mortgage loan (*i.e.*, the promissory note) has a long history in the residential housing industry, which the Washington Legislature has endorsed.

As the Deed of Trust here clearly states, MERS was an agent acting on behalf of IndyMac (and IndyMac's successors and assigns):

---

106 *See, e.g., Jones, supra* note 3, at 36 (noting that the entity servicing the loan was designated the mortgagee of record).

107 Mozilo, *supra* note 105, at 14.

108 *See, e.g., Consol. Mortg. & Fin. Corp. v. Landrieu,* 493 F. Supp. 1284, 1286-87 (D.D.C. 1980) (discussing Mortgage Backed Securities Program and Ginnie Mae's role).

109 Mozilo, *supra* note 105, at 14.

"MERS (as nominee for [IndyMac] and [IndyMac's] successors and assigns) has the right: to exercise all of [IndyMac's rights], including, but not limited to, the right to foreclose and sell the Property; and to take any action required of [IndyMac.]"[110] IndyMac was the holder of the Promissory Note. The fact that MERS is identified as the "beneficiary" under the Deed of Trust ("acting solely as a nominee [or agent] for" IndyMac[111]) does not eviscerate this agency relationship.[112] To the contrary, the identification of MERS as the acting agent for IndyMac in the Deed of Trust is squarely consistent with the law of agency and the requirement that, under the Act, the "beneficiary" means "the holder of the instrument or document evidencing the obligations secured by the deed of trust ...."[113] This is because, here, the "holder" of the note was IndyMac (later its successor), and the agent of that "holder" under the Deed of Trust was MERS. And all of this was plainly know by Plaintiff. *The entire relationship between the parties, and each party's role in the transaction,*

---

110 Dkt. No. 131-2, at 4 of 18.

111 Dkt. No. 131-2, at 2 & 4 of 18.

112 *See Udall*, 159 Wn.2d at 911 (recognizing that the Act cannot be used to avoid foreclosure based on ministerial acts, even if those acts are made by mistake).

113 RCW 61.24.005(2).

was fully disclosed to Plaintiff at the very outset of the relationship. Nothing was hidden![114]

To find in favor of Bain, the Court would have to overturn decades-old Washington law that permits the use of agents.

4. The Courts Repeatedly Find In Favor Of MERS, Striking Down The Very Arguments Plaintiff Asserts Here.

The United States District Court for the Western District of Washington has recently issued a series of opinions on the very issues before the Court, finding in favor of MERS.[115] In *Daddabbo v. Countrywide Home Loans, Inc.*,[116] plaintiff challenged a non-judicial foreclosure based on MERS' status as beneficiary under the Act because MERS did not hold the promissory note.[117] The court rejected plaintiff's arguments, ruling, "the deed of trust, of which the court takes judicial notice, explicitly names MERS as beneficiary. The deed of trust grants MERS not only legal title to the interests created in the trust, but the

---

[114] Plaintiff quotes what Plaintiff calls an "admission" from Lenders Processing Service ("LPS"), a defendant that was dismissed from the case, regarding MERS's agency role. Opening Brief, at 11. It is not clear what inference Plaintiff hopes to draw from this quote, but to be clear, MERS did not authorize LPS to make any "admissions" regarding MERS, and any statements made by LPS are not binding on MERS.

[115] MERS agrees with Judge Coughenour that this Court should weigh in on the issues certified to this Court, but MERS also believes that this series of decisions from the Western District of Washington were correctly decided and reflect the judicial perspective of experienced and respected judges applying Washington law.

[116] 2010 WL 2102485 (W.D. Wash. May 20, 2010).

[117] *Id.* at *5.

authorization of the lender and any of its successors to take any action to protect those interests, including the right to foreclose and sell the Property."[118]

More recently, in *St. John v. Northwest Trustee Services, Inc.*,[119] plaintiff similarly argued that a non-judicial foreclosure should be enjoined on the basis that "MERS lacked authority to act as beneficiary under the Deed of Trust and thus could not assign its beneficial interest."[120] The Court rejected the argument, ruling, "This Court has previously and consistently ruled that, when a plaintiff affixes a deed of trust that he/she signed wherein MERS is named as a beneficiary with the right to transfer such rights, the plaintiff's arguments that MERS is not a beneficiary under the security instrument are without merit."[121]

In *Vawter v. Quality Loan Servicing Corp. of Washington*,[122] plaintiff advanced the same argument, challenging a non-judicial foreclosure based, in part, on "MERS' role as beneficiary on the Deed of

---

118 *Id.* (considering documents identifying the trust company as the holder of the note and finding, those documents do not 'remotely support Plaintiffs' assertion that MERS somehow has been stripped of the power that the deed of trust grants." (internal citations omitted)).

119 W.D. Wash. Case No. 11-cv-5382 (Sept. 29, 2011 Dismissal Order).

120 *Id.* at 5.

121 *Id.*

122 707 F. Supp.2d 1115 (W.D. Wash. 2010).

Trust" where MERS did not hold the note.[123] Again, the *Vawter* court rejected the argument, finding that plaintiff's allegations could not survive Rule 12 dismissal.[124]

Daddabbo, *St. John*, and *Vawter* are just three of a number of cases that reject the very arguments Plaintiff asserts here.[125] These cases, and other similar cases, must be contrasted with the near non-existence of cases finding against MERS. The cases cited by Plaintiff are inapposite.

Plaintiff discusses *Mortg. Elec. Registration Sys., Inc. v. Nebraska Dep't of Banking & Fin.*[126] at length.[127] The inference Plaintiff attempts to

---

123 *Id.* at 1125.

124 *Id.* at 1126.

125 There are a number of similar decisions that find in favor of MERS, all of which cannot be discussed at-length here. *See, e.g., Corales v. Flagstar Bank, FSB*, W.D. Wash. Case No. 10-cv-1922 (Oct. 14, 2011 Order Granting Motion for Summary Judgment) (rejecting argument that MERS is not a valid beneficiary, where plaintiff contractually agreed it was); *Cebrun v. HSBC Bank*, 2011 WL 321992, *3 (W.D. Wash. Feb. 2, 2011) ("courts consistently hold, when evaluating similar deeds, that MERS acted as a beneficiary and possessed the rights set out above"); *Salmon v. Bank of America Corp.*, 2011 WL 2174554, *6 (E.D. Wash. May 25, 2011) (rejecting argument that MERS is a "ghost beneficiary" and not a "beneficiary" as that term is defined by the Act); *Klinger v. Wells Fargo Bank*, 2010 WL 5138478, *7 (W.D. Wash. Dec. 9, 2010) (agreeing with rulings in *Daddabbo* and *Vawter*, thus dismissing plaintiffs' contention that MERS was not a valid beneficiary); *Moon v. GMAC Mortg. Corp., et al.*, 2009 WL 3185596, *6 (W.D. Wash. Oct. 2, 2009) (recognizing MERS as beneficiary under deed of trust); *see also Gomes v. Countrywide Home Loan, Inc.*, 192 Cal. App. 4th 1149 (2011) (holding that plaintiff, by executing the deed of trust, specifically agreed MERS had the authority to act under the deed of trust); *Pantoja v. Countrywide Home Loans, Inc.*, 640 F. Supp.2d 1177, 1189 (N.D. Cal. 2009) ("Plaintiff distinctly granted MERS the right to foreclose through the power of sale provision" and, therefore, "[p]ursuant to the terms of the Deed of Trust [and California's non-judicial foreclosure statute], as a beneficiary, MERS has a right to conduct the foreclosure process."); *Silvas v. GMAC Mortg., LLC*, 2009 WL 4573234, at *8 (D. Ariz. 2009) ("MERS [is] empowered to act on behalf of whoever was the equitable owner of the rights in the Deed of Trust").

126 270 Neb. 529 (2005).

draw is that *Nebraska Dep't of Banking* somehow concluded that MERS conducts unlawful business practices or otherwise cannot be a "beneficiary" under the Act. Any such inference is unfounded. *Nebraska Dep't of Banking*, has nothing to do with whether MERS can act as a lawful beneficiary. *Nebraska Dep't of Banking* was not even a foreclosure case. It was a case about licensing under Nebraska law – *i.e.*, whether MERS needed to be licensed as a mortgage banker in Nebraska. The answer, although irrelevant to these proceedings, was "No" because MERS is not a loan originator.[128]

Plaintiff also relies on *Landmark Nat'l Bank v. Kesler*[129] and *Mortg. Elec. Registration Sys., Inc. v. Southwest Homes of Arkansas, Inc.*[130] *Landmark* and *Southwest Homes* are equally of no help to Plaintiff. Neither *Landmark* nor *Southwest Homes* involved beneficiary status in a non-judicial foreclosure action. The issue in both *Landmark* and *Southwest Homes* was whether notice of a *judicial* action had to be provided to MERS, the designated beneficiary for the lender, where notice

---

127 Opening Brief, at 15-17.

128 *Nebraska Dep't of Banking*, 270 Neb. at 530. MERS's position in *Nebraska Dep't of Banking* is consistent with its position here – *i.e.*, MERS holds legal title to the Deed of Trust as the agent of the lender and is authorized to act on behalf of the lender.

129 289 Kan. 528 (Kan. 2009).

130 301 S.W. 3d 1 (Ark. 2009).

had already been provided to the lender. The cases are factually unique and of no bearing.

On the unique facts of the case, *Landmark* concluded notice to MERS was not required, but the Kansas Legislature later overturned that limited holding. Kansas law now requires that any nominee of record be notified in judicial foreclosure proceedings, including MERS.[131] Similarly, in *Southwest Homes,* the Arkansas Supreme Court concluded that notice to MERS was unnecessary when the lender had already received notice[132] —not that MERS was prohibited from serving as mortgagee and agent for the lender. In fact, an Arkansas federal district court later distinguished *Southwest Homes* when it held that MERS, as agent for the lender, was authorized as mortgagee of record to assign the mortgage to another lender.[133] Simply put, *Landmark* and *Southwest Homes* have no bearing on the issues before the Court.[134]

---

131 Kan. Stat. Ann. § 60-219(e).

132 *Southwest Homes,* 301 S.W. 3d at 1-2, 5.

133 *See Coley v. Accredited Home Lenders, Inc.*, 2011 WL 1193072, at *4 (E.D. Ark. Mar. 29, 2011). Notably, if notice to MERS had been required in *Landmark* and *Southwest Homes*, both courts would have had to set aside the sale of property to third parties, something they were not inclined to do.

134 *Mortg. Elec. Registration Sys., Inc. v. Saunders*, 2 A.3d 289 (1st Cir. 2010) is also inapposite. *See* Opening Brief, at 40-41. As Plaintiff herself acknowledges, *Saunders* did not involve interpretation of a statutory definition of "beneficiary" or whether a lender can use an agent to act on its behalf as a beneficiary under a deed of trust. *Saunders* involved the application of constitutional and prudential standing requirements in *judicial* foreclosure proceedings. No such standing requirements exist in non-judicial foreclosure proceedings.

Plaintiff also briefly mentions the recent Michigan court of appeals decision in *Residential Funding Co., LLC v. Saurman*,[135] which did call MERS into question. With respect, *Saurman* was wrongly decided, is flatly undermined by a vast array of Michigan state cases that find to the contrary,[136] and is on appeal before the Supreme Court of the State of Michigan. In coming to the wrong ruling, respectfully, the *Saurman* court ignored the fact that, under Michigan law, a mortgagee of record with power of sale is authorized to foreclose, and ignored Michigan's long-

---

Fidelity & Deposit Co. of Maryland v. Ticor Title Ins. Co., 88 Wn. App. 64 (1997) and *Walcker v. Benson and McLaughlin*, 79 Wn. App. 739 (1995), are also inapposite. *See* Opening Brief, at 33-38. *Ticor* involved the assignment of a forged note, and ultimately stands for the non-controversial proposition that to foreclose, a default must occur on the obligation secured. *Ticor*, 88 Wn. App. at 68-70. In *Walcker*, the beneficiary under the deed of trust was also the holder of the note and had to do with whether the limitations period had run. *Walcker*, 79 Wn. App. at 740-41. Neither case addresses whether the parties can contractually agree that a lender can appoint an agent to act on its behalf as a beneficiary under a deed of trust.

135 --- N.W.2d ---, 2011 WL 1516819 (Mich. App., April 21, 2011).

136 *See, e.g., Amera Mortg. Corp. v. Schatz*, LT-05-6565 (Wayne Cnty. Ct. Ct. Feb. 17, 2006); *Murray v. Mortg. Elec. Registration Sys., Inc.*, Civ. No. 06-623719-CH (Wayne Cnty. Cir. Ct. Feb. 6, 2007); *Bank of N.Y. v. Diefenbach*, Civ. No. 07-11691-AV (Kent County Cir. Ct. May 23, 2008); *Wilson v. Mortg. Elec. Registration Sys., Inc.*, Civ. No. 08-090519-CH (Oakland Cnty. Cir. Ct. Aug. 6, 2008); *Aurora Loan Servs., LLC v. Yono*, Civ. No. 2008-DA8884-AV (Oakland Cnty. Cir. Ct. Feb. 25, 2009); *U.S. Bank Nat'l Ass'n v. Ghaddar*, Case No. 08LT1282 (19th Jud. Dist. Ct. Jan. 4, 2010); *U.S. Bank Nat'l Ass'n v. Leverette*, Civ. No. 10-303417-LT (Wayne Cnty. Dist. Ct. Apr. 16, 2010); *Wells Fargo Bank, N.A. v. Craig*, Case No. 10-1289-LT (8th Jud. Dist. Ct. Apr. 19, 2010); *Voydanoff v. Select Portfolio*, No. 09-102194-CK (Oakland Cnty. Cir. Ct. Apr. 28, 2010); *Procopio v. Guaranteed Rate, Inc.*, #2010-0290-CH (Macomb Cnty. Cir. Ct. June 4, 2010); *Basinger v. Bank of Am., N.A.*, #10-652-CH (Eaton Cnty. Cir. Ct. July 23, 2010); *U.S. Bank Nat'l Ass'n v. Greficz*, #08-1219 LT (21st Dist. Ct. Nov. 8, 2010); *see also Safford v. Precision Funding*, 2010 WL 548504 (E.D. Mich. Feb. 9, 2010); *Brown v. Countrywide Home Loans*, No. 2010 WL 1136515 (E.D. Mich. Mar. 24, 2010); *Robbins v. Mortg. Elec. Registration Sys., Inc.*, No. 2009 WL 3757443 (W.D. Mich. Nov. 9, 2009); *Corgan v. Deutsche Bank Nat'l Trust Co.*, No 09-cv-939 (W.D. Mich. July 20, 2010).

standing law on agency.[137] The *Saurman* court also incorrectly found that MERS did not have an interest in the obligations owed through the at-issue deeds of trust.[138] MERS respectfully submits that this Court should disregard the Michigan appellate court's erroneous ruling in *Saurman*, which is currently under review.[139]

B. Even If MERS Was Not A Proper Beneficiary Under The Deed Of Trust Act, That Would Not Have Any Material Effect.

As discussed above, MERS is a proper beneficiary under the Deed of Trust Act. Thus, the second certified question is moot. But even if MERS was not a proper beneficiary, that would not have any material effect on Plaintiff's purported claims. If MERS was not a proper beneficiary, that would not mean Plaintiff does not have to repay her loan. It would not mean that her Deed of Trust would somehow vanish. And it should not mean that the lender is unable to foreclose on her property, despite her default. All that it would mean is that there was a technical violation of the Deed of Trust Act that all parties were aware of when the loan was originally entered into. At most, the lender should have to

---

137 *Saurman*, 2011 WL 1516819.

138 *Id.*

139 The Court should also disregard Plaintiff's characterization of MERS's recommendations regarding foreclosures in Colorado. *See* Opening Brief, at 39-40. Those recommendations have nothing to do with whether MERS is a proper beneficiary under Washington's Deed of Trust Act. Rather, they reflect an interpretation of a unique requirement under Colorado law that does not exist in Washington.

establish a clear right to foreclose before moving forward. To do that, MERS would simply need to assign its legal interest in the Deed of Trust to the lender before the lender proceeded with foreclosure. Anything more would be an indefensible windfall for Plaintiff, which is surely not what the Legislature intended when it enacted the Act.[140]

Under Plaintiff's construction, the note would still be secured because, as Plaintiff interprets it, the term "beneficiary" means the lender (not MERS as the agent of the lender). Even under this construction, there is (as there must be) a secured party – the lender.[141] Under Plaintiff's definition, therefore, MERS would still have contract rights in the deed of trust, which it could (and would need to before foreclosure) freely assign to the lender.[142] That is all. It is a distinction without a difference.

The Deed of Trust Act was not enacted to add layers of complication and confusion to the foreclosure process. To the contrary, as this Court has stated, the Deed of Trust Act should be construed to further three basic objectives: (1) "the nonjudicial foreclosure process should remain efficient and inexpensive[;]" (2) "the process should provide an

---

[140] *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

[141] Under either construction, the secured party is either the lender directly, or MERS as the contractually agreed to agent for the lender.

[142] Notably, in this case, MERS did assign its rights in the Deed of Trust to the lender to facilitate foreclosure.

adequate opportunity for interested parties to prevent wrongful foreclosure[;]" and (3) "the process should promote the stability of land titles."[143] These objectives are not advanced by allowing Plaintiff, who is in default, to challenge the foreclosure of her property based on a claimed technical violation of the Act where Plaintiff contractually agreed to that purported violation.

The purpose of recording statutes is not to protect borrowers.[144] Borrowers know to whom they must make their mortgage payments. Recording statutes are designed to protect lenders and the outside world. It is critical to note that, if Plaintiff's contention were correct – *i.e.*, that MERS cannot be a "beneficiary" under deeds of trust in the State of Washington – it would not only affect non-judicial foreclosures. It would have a profound effect on the stability of land title records of hundreds of

---

[143] *Cox v. Helenius*, 103 Wn.2d 383, 387 (1985) (en banc). Bain discusses *Cox* at length to make the point that, post-*Cox*, any party involved in the foreclosure process in Washington should know that Washington courts expect strict adherence to foreclosure requirements. Opening Brief, at 23-26. MERS need not debate the impact of *Cox*. As discussed above, MERS did not violate the Act and so MERS did not run afoul of *Cox*.

[144] It is important to keep in mind that the Deed of Trust Act (and similar statutes around the country) is *not* a consumer protection statute. It is designed to provide for faster, more efficient foreclosures for lenders. *Cox*, 103 Wn.2d at 387. Certainly, its provisions must be followed, but Plaintiff's implication that the Act is designed as a sword for borrowers is inaccurate.

thousands of properties in Washington, effectively rendering those records unstable.[145]

Moreover, even if there was a recording violation (there was not), it did not harm Plaintiff in any way. And such violation, if any, did not contravene any public policy objectives noted by the Court in *Cox* that underscore the Act. At most, the only legal impact the violation should have (if the Court were to conclude there was a violation) is that MERS should be required to assign its interest in any deed of trust to the holder of the promissory note, and have that assignment recorded in the land title records, before any non-judicial foreclosure could take place. It certainly should not result in a void deed of trust, both legally and from a public policy standpoint.[146] The existence of MERS as the contractually agreed "beneficiary" in hundreds of thousands of deeds of trust in the State of

---

[145] For example, without limitation, such a determination would call into question the status of land title records on thousands of Washington properties where MERS has executed releases of liens or reconveyances of property for borrowers who have paid off their loans.

[146] Another theory Plaintiff appears to be advancing is one that has been consistently rejected by courts around the country. The existence of MERS as the beneficiary under the Deed of Trust does not result is a "split" of the Promissory Note and Deed of Trust, rendering the Deed of Trust void. *See, e.g.*, *Horvath v. Bank of N.Y., N.A.*, 641 F.3d 617, (4th Cir. 2011) ("Indeed, common sense suggests that things could not be any other way. If [plaintiff] were correct in asserting that the transfer of a note splits it from the deed of trust ..., there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, but on [plaintiff's] view, transferring a note would strip it from the security that gives it value and render the note legally worthless. This cannot be – and is not – the law."); *In re Martinez*, No. 11-7007 (U.S. Bankr. Ct. D. Kan., Feb. 2. 2011 and Apr. 20, 2011) ("no 'fatal' splitting of the Note and Mortgage occurred").

Washington cannot reasonably mean that the loans associated with those deeds are not secured.[147]

C. There Is No Consumer Protection Act Claim Against MERS.

Bain, and others similarly situated, do not possess a cause of action against MERS under Washington's Consumer Protection Act ("CPA"). The elements of a CPA claim are: (1) an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) that impacts the public interest; (4) causing injury to the plaintiff's business or property; and (5) that injury is causally linked to the unfair or deceptive act.[148] Bain, and others, cannot satisfy at least three of these elements.

1. MERS Has Not Engaged In An Unfair Or Deceptive Act Or Practice.

There are two ways that Plaintiff can establish the first element of a CPA claim:

> [W]e have recognized that consumers may establish the first element in two ways. They may show either that an act or practice 'has a capacity to deceive a substantial portion of the public,' or that 'the alleged act constitutes a *per se* unfair trade practice.'[149]

---

147 *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

148 *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 780 (1986).

149 *Saunders v. Lloyd's of London*, 113 Wn.2d 330, 344 (1989) (quoting *Hangman Ridge*, 105 Wn.2d at 785-86).

Only the Washington Legislature can establish a *per se* CPA violation, and it can do so only by making a specific legislative declaration to that effect.[150] Plaintiff does not assert that MERS committed a *per se* CPA violation, nor can she. Thus, the only way for Plaintiff to establish a CPA claim against MERS is to show that MERS engaged in deceptive conduct. But as discussed above, Plaintiff has not and cannot do that. MERS is a proper beneficiary under Plaintiff's Deed of Trust, both contractually and legally. MERS has made no misrepresentations or misstatements to Plaintiff. To the contrary, MERS fully described its role to Plaintiff through the very contract documents that Plaintiff signed. MERS did not engage in any conduct that was unfair, deceptive or misleading. Everything was fully disclosed and agreed to by Plaintiff. Even if, *arguendo*, the Court ruled that MERS incorrectly concluded that it was a legal beneficiary under Washington deeds of trust, MERS fully disclosed its role to borrowers and did not affirmatively misrepresent or knowingly misstate anything to borrowers.

2. The Act Being Challenged Did Not Have The Capacity To Impact A Substantial Portion Of The Public.

A plaintiff asserting a CPA claim must also show that the act

---

[150] *Hangman Ridge*, 105 Wn.2d at 787, 791 ("it has become clear that the Legislature, not this court, is the appropriate body to establish ... a *per se* unfair trade practice").

complained of impacts the public interest and has the capacity to "deceive a *substantial portion of the public.*"[151] Acts that impact only the plaintiff or a limited group do not have the capacity to deceive a substantial portion of the public as a matter of law, "no matter how misleading."[152]

Thus, the foundational question is, what act or acts are being challenged, regardless of whether they are misleading? Here, Plaintiff challenges an isolated act by MERS – *MERS's role as the beneficiary under Plaintiff's Deed of Trust in the context of the foreclosure proceedings on Plaintiff's property.* Plaintiff contends that MERS misled Plaintiff with respect to that role. Even if that were true (which it is not), it would have the capacity to deceive and impact *only* Plaintiff, not a "substantial portion of the public."[153] Other than bald statements that the public was deceived, Plaintiff has made no effort to show how the challenged conduct had any impact on anyone besides Plaintiff.[154] Thus, Plaintiff has not established, and cannot establish,

---

[151] *Segal Co. (Eastern States), Inc. v. Amazon.com*, 280 F. Supp.2d 1229, 1232 (W.D. Wash. 2003); *Hangman Ridge*, 105 Wn.2d at 780.

[152] *Henery v. Robinson*, 67 Wn. App. 277, 291 (1992); *see also Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*, 86 Wn. App. 732, 744-45 (1997) (dismissing plaintiff's CPA claim, in part, because the challenged acts were not directed at the public).

[153] *Segal Co.*, 280 F. Supp.2d at 1232; *Hangman Ridge*, 105 Wn.2d at 780.

[154] Notably, Plaintiff's claims based on conduct by other defendants is not attributable to MERS, since the CPA does not permit assignee liability. *See White v.*

that a substantial portion of the public was impacted by the representations, if any, that MERS made to Plaintiff.

3. Plaintiff Suffered No Injury Caused By MERS.

Finally, Plaintiff must plead and show a causal link between the alleged misrepresentation or deceptive act and her purported injury.[155] In *Indoor Billboard,* the Court applied the proximate cause standard set forth in Washington Pattern Jury Instruction 15.01 to CPA claims, requiring a plaintiff to prove that but for the defendant's allegedly unfair or deceptive practice, the plaintiff would not have been harmed.[156]

Plaintiff does not (and cannot) allege a causal link between the alleged wrongful act by MERS and any harm to Plaintiff. Plaintiff took out a loan in 2007, and then promptly defaulted on that loan in 2008. Plaintiff has been occupying the at-issue property since that time without paying for it. The "harm" Plaintiff claims she has suffered is that (she claims) she does not know who to make payments to on her

---

Homefield Fin., Inc., 545 F. Supp. 2d 1159, 1170 (W.D. Wash. 2008); *Kucheynik v. Mortg. Elec. Registration Sys., Inc.*, 2010 WL 5174540, *3 (W.D. Wash. Dec. 15, 2010) (MERS not liable under CPA for deceptive acts during loan origination process in which MERS was not involved). Thus, Plaintiff's assertion that the foreclosure efforts (made by other parties) was wrongful does not give rise to a CPA claim against MERS. *Id.*; *see* Opening Brief, at 45.

155 *Indoor Billboard v. Integra Telecom*, 162 Wn.2d 59, 81-82 (2007).

156 *Id.*

home loan. But there is no allegation or proffered evidence that any purported deficiency in the recording of documents evidencing Plaintiff's loan caused her inability to pay on her loan or confusion about who to pay.[157] Setting aside whether Plaintiff genuinely questions who she must make payments to under her loan to cure the default, that issue has nothing to do with MERS and is not in any way causally linked to MERS's identity as the beneficiary under the Deed of Trust. Plaintiff has suffered no damage as a result of any conduct by MERS.[158]

MERS respectfully disagrees with Plaintiff's suggestion that the Washington Legislature, through its silence, intended for defaulting home loan borrowers to be entitled to assert a claim under the CPA merely because they assert a claim under the Deed of Trust Act.[159] Plaintiff has not established a CPA claim here, and there is no claim to be had under the CPA for MERS's contractual role as the beneficiary under a deed of trust that is subject to the Washington Deed of Trust Act.

---

[157] Frankly, Plaintiff's assertion that she did not know who to pay (if she is making that assertion) is nonsensical. Borrowers are fully apprised of the identity of the servicers on their loan, throughout the life of their loan, which is the party to whom they must make payments, and with whom they must work to cure defaults in the loan.

[158] To the extent Plaintiff contends that her claimed emotional distress constitutes "damages," that still would not give rise to damages under the CPA. "Damages for emotional distress are not recoverable for a violation of the CPA." *Johnson v. Cash Store*, 116 Wn. App. 833, 849 (2003).

[159] Opening Brief, at 46 ("the more likely interpretation of the Legislature's intentions is that it did not feel the need to state the obvious").

V. CONCLUSION.

For the foregoing reasons, MERS respectfully requests that the Court hold that MERS is a lawful "beneficiary" under the Deed of Trust Act, RCW 61.24.005(2). Further, MERS respectfully requests that the Court hold that a Washington Consumer Protection Act claim does not exist against MERS for its role as a deed of trust beneficiary in Washington deeds of trust.

RESPECTFULLY SUBMITTED this 20th day of October, 2011.

Russ Wuehler, WSBA No. 37941
DLA PIPER LLP (US)
701 Fifth Avenue, Suite 7000
Seattle, WA 98104
Phone: 206.893.4800
Fax: 206.839.4801

Robert J. Pratte (*Pro Hac Vice*)
DLA PIPER LLP (US)
90 South Seventh Street, Suite 5100
Minneapolis, MN 55402
Phone: 612.524.3000
Fax: 612.524.3001

Counsel for Defendant Mortgage Electronic Registration Systems, Inc.

APPENDIX

A.1. Arnold, R.K., *Yes, There Is Life On MERS*, 11 PROB. & PROP. 33 (1997) 11, 12, 13

A.2. *Corales v. Flagstar Bank, FSB*, W.D. Wash. Case No. C10-1922 (Oct. 14, 2011 Order Granting Motion for Summary Judgment) 37

A.3. H.R. REP. NO. 101-54(I), (1989), reprinted in 1989 U.S.C.C.A.N. 86 11

A.4. Jones, Allen H., Setting the Record Straight on MERS, MORTG. BANKING 34 (May 2011). ..... *passim*

A.5. Friedman, Milton R., Friedman on Contracts & Conveyances of Real Property, § 6:1:5 *Nominees* 31

A.6. Miller, Jeffrey J., *The Effect of the S&L Bailout on Title to Real Property*, 5 PROB. & PROP. 44 (1991) 12

A.7. Mozilo, Angelo R., A Century's Milestones in Residential Lending, MORTG. BANKING 13 (Jan. 2000) 32, 33

A.8. Restatement (Third) of Property (Mortgages) § 5.4, cmt. e (1997). 32

A.9. Slesinger, Phyllis K. & McLaughlin, Daniel, *Mortgage Electronic Registration System*, 31 Idaho L. Rev. 805, 809 (1995) 10

A.10. *St. John v. Northwest Trustee Services, Inc.*, W.D. Wash. Case No. C11-5382 (Sept. 29, 2011 Dismissal Order) 36, 37

EAST\45592069.6

APPENDIX

A.1. Arnold, R.K., *Yes, There Is Life On MERS*, 11 PROB. & PROP. 33 (1997) 11, 12, 13

A.2. *Corales v. Flagstar Bank, FSB*, W.D. Wash. Case No. C10-1922 (Oct. 14, 2011 Order Granting Motion for Summary Judgment) 37

A.3. H.R. REP. NO. 101-54(I), (1989), reprinted in 1989 U.S.C.C.A.N. 86 11

A.4. Jones, Allen H., Setting the Record Straight on MERS, MORTG. BANKING 34 (May 2011). ..... *passim*

A.5. Friedman, Milton R., Friedman on Contracts & Conveyances of Real Property, § 6:1:5 *Nominees* 31

A.6. Miller, Jeffrey J., *The Effect of the S&L Bailout on Title to Real Property*, 5 PROB. & PROP. 44 (1991) 12

A.7. Mozilo, Angelo R., A Century's Milestones in Residential Lending, MORTG. BANKING 13 (Jan. 2000) 32, 33

A.8. Restatement (Third) of Property (Mortgages) § 5.4, cmt. e (1997). 32

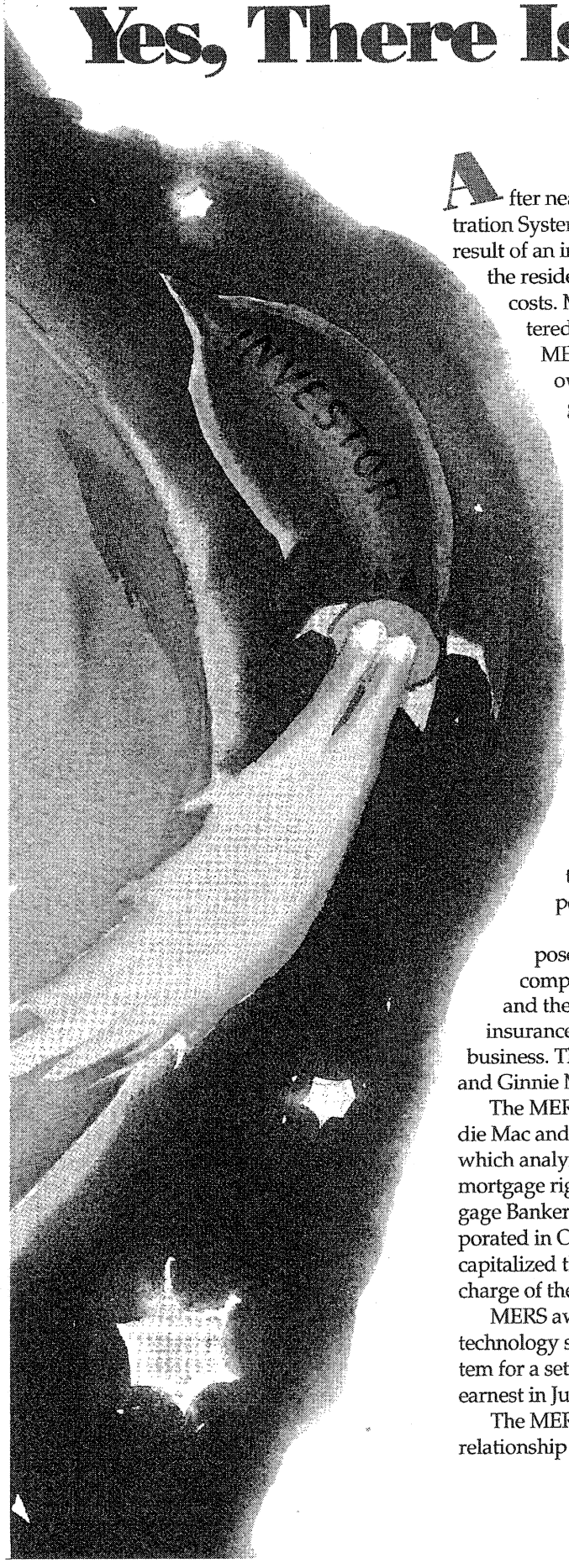
A.9. Slesinger, Phyllis K. & McLaughlin, Daniel, *Mortgage Electronic Registration System*, 31 Idaho L. Rev. 805, 809 (1995) 10

A.10. *St. John v. Northwest Trustee Services, Inc.*, W.D. Wash. Case No. C11-5382 (Sept. 29, 2011 Dismissal Order) 36, 37

EAST\45592069.6

APPENDIX A.1

Yes, There Is Life on MERS



By R. K. Arnold

After nearly four years on the drawing board, Mortgage Electronic Registration Systems, Inc., commonly known as MERS™, is a reality. MERS is the result of an industry effort to reduce the need for mortgage assignments in the residential mortgage market and thus increase efficiency and reduce costs. MERS will act as mortgagee of record for any mortgage loan registered on the computer system MERS maintains, which is called the MERS System™. It will then track servicing rights and beneficial ownership interests in those loans and provide a platform for mortgage servicing rights to be traded electronically among its members without the need to record a mortgage assignment in the public land records each time.

Some have called MERS the most significant event for the mortgage industry since the formation of Fannie Mae and Freddie Mac. Others have compared it to the creation of uniform mortgage instruments, which have become standard throughout the residential mortgage industry. This suggests that the journey to MERS will have a tremendous effect on the mortgage industry.

What Is MERS?

MERS is a Delaware nonstock corporation owned by its members, who, in most cases, are also its users. Members pay annual fees to belong and transaction fees to execute electronic transactions on the MERS System. Members exercise control of the company through a board of directors who serve staggered two year terms. The board is empowered to set rules, fees and penalties for operating the MERS System.

MERS has three classes of membership: the Agency Class, composed of Fannie Mae and Freddie Mac; the Lender/Servicer Class, for companies engaged primarily in lending and servicing mortgage loans; and the Related-Industry Class, which includes title companies, mortgage insurance companies and others indirectly involved with the mortgage business. The federal government agencies focused on housing—FHA, VA and Ginnie Mae—serve on the MERS Advisory Council.

The MERS project formally began in October 1993 when Fannie Mae, Freddie Mac and Ginnie Mae published the Whole Loan Book Entry White Paper, which analyzed the need for an electronic mortgage registration system for mortgage rights. The acronym MERS was coined soon thereafter. The Mortgage Bankers Association of America played a key role until MERS was incorporated in October 1995 and is a charter member. The charter members initially capitalized the company and the company hired an executive team to take charge of the project on a full time basis in February 1996.

MERS awarded a contract to Electronic Data Systems (EDS) to develop the technology system. MERS owns and controls the system; EDS services the system for a set portion of the transaction fees. System development began in earnest in July 1996 and MERS officially launched in April 1997.

The MERS System is a secure network. Access levels depend on a member's relationship to a particular mortgage loan. For instance, servicers and investors

can update only their own loan files. Other members and the general public can see certain information about the servicer, such as its name, address and telephone number, but cannot access information about the investor or other proprietary data. The software is easy to use. It is Windows-based and designed to run on a 386 computer. On-line access through a modem is available using MERS proprietary desktop software. Batch transactions can be processed using EDI data format ANSI ASC X12 or a flat file format.

MERS currently charges a registration fee of between $3.20 and $3.50 to register a loan on the system and a transfer fee of between $8.20 and $8.50 to transfer servicing electronically. There is a substantial discount if a member prepays the transfer fee at the time a loan is registered. The annual membership fees currently range from $500 to $7,500, depending on a member's size and types of business. These fees are more than offset by the document preparation and filing costs that MERS eliminates. At present, the MERS System is limited to single-family first mortgage loans.

Why the Need for MERS?

A mortgage note is normally a negotiable instrument under UCC Article 3. One holder can thus sell a mortgage note to another in what has become a gigantic secondary market. The holder of the note is either the beneficial owner of the mortgage loan or a designee who holds the note on behalf of that beneficial owner. These beneficial owners and their representatives are sometimes called investors.

Under UCC § 3-203, the right to receive payments under a note is legally transferred when one holder negotiates the note to another by endorsement and delivery. As security for the payment obligation, the mortgage follows the note without the need for further documentation. See, e.g., *In Re Ivy Properties*, 109 B.R. 10 (Bankr. D. Mass. 1989); *W.C. Early Co. v. Williams*, 186 S.W. 102, 103 (Tenn. 1916); *Spencer v. Alki Point Transp. Co.*, 101 P. 509, 514 (Wash. 1909); *Hillard v. Taylor*, 38 So. 594, 598 (La. 1905). The negotiability of notes under the UCC is the foundation for the secondary market for mortgage loans. As a result, the U.S. housing market is the envy of the entire world. Home ownership in most other countries is far less attainable, largely because financing is not as readily available. The ability of lenders to replenish their capital by selling loans in the secondary market is what makes money accessible for home ownership.

As investors bought more and more loans in the secondary market, many of them began to contract with servicing companies to handle loan servicing obligations. A servicer is a company that a mortgage loan investor hires to handle payment processing, tax and insurance escrows, foreclosure and other matters related to the loan or the property. Often, the servicer is the same lender that originated the loan, sold the beneficial ownership in the secondary market and agreed to continue servicing the loan for the new beneficial owner.

For these servicing companies to perform their duties satisfactorily, the note and mortgage were bifurcated. The investor or its designee held the note and named the servicing company as mortgagee, a structure that became standard. Some servicing companies have grown quite large, and a very active secondary market in servicing contracts has developed as well. Now more than $400 billion in servicing contracts trade annually.

A servicing contract is not an interest in real estate. Unlike a mortgage, it has nothing to do with legal title to the property and is personal property under UCC § 9-106. Even before MERS, servicers had no reason to appear in the public land records, except to receive the legal process they need to service loans properly.

The bifurcated structure worked fine for a long time, but the sheer volume of transfers between servicing companies and the resulting need to record assignments caused a heavy drag on the secondary market. The burden affected lenders, title companies, consumers and even local recorders. Assignment processing for the sale of a relatively modest loan portfolio can take up to six months to complete. Error rates as high as 33% are common. With the active secondary market in servicing contracts, more than four million loans are affected annually. Loan servicing can trade several times before even the first assignment in a chain is recorded, leaving the public land records clogged with unnecessary assignments. Sometimes these assignments are recorded in the wrong sequence, clouding title to the property.

How Does MERS Work?

When a mortgage loan is registered on the MERS System, it receives a mortgage identification number (MIN). The borrower executes a traditional paper mortgage naming the lender as mortgagee, and the lender executes an assignment of the mortgage to MERS. Both documents are executed according to state law and recorded in the public land records, making MERS the mortgagee of record. From that point on, no additional mortgage assignments will be recorded because MERS will remain the mortgagee of record throughout the life of the loan. In states where deeds of trust are used instead of mortgages, MERS is typically named as beneficiary of the deed of trust.

The MIN is unique and will not change during the life of the loan. That innovation alone is a tremendous improvement for the mortgage industry. Each time a loan not registered on MERS is sold on the secondary market, it receives a new loan number. Those multiple loan numbers can cause considerable confusion and additional record keeping over the life of a 30 year loan. The MIN is never used again for another loan. That reduces the risk of multiple funding of the same loan by different lenders, which is a significant cause of fraud loss for the mortgage industry. As a

result of these advantages, many lenders may eventually abandon their own proprietary loan numbering systems in favor of the MIN.

As mortgagee of record or beneficiary of the deed of trust, MERS receives service of all legal process related to the property. One of the most important things MERS does is operate a state-of-the-art electronic mailroom. When mail is physically received in the MERS mailroom, it is imaged and forwarded electronically to the company shown as servicer for that loan on the MERS System. The servicer then responds as required under its servicing contract with the investor.

Once a member registers a mortgage loan on the MERS System, later transfers of the servicing contract are executed electronically through MERS. When one servicer trades servicing rights to another, the transfer is initiated by the old servicer. After the new servicer confirms the transfer, the MERS System is updated to reflect the new servicer as the proper recipient of future legal process. The Real Estate Settlement Procedures Act (RESPA) requires both the old servicer and the new servicer to notify the homeowner in writing when loan servicing is traded—the so-called "hello/goodbye letters." 12 U.S.C. §§ 2601 et seq. Servicing can change hands often, in some cases several times a year for the same loan, and homeowners have become quite familiar with these letters.

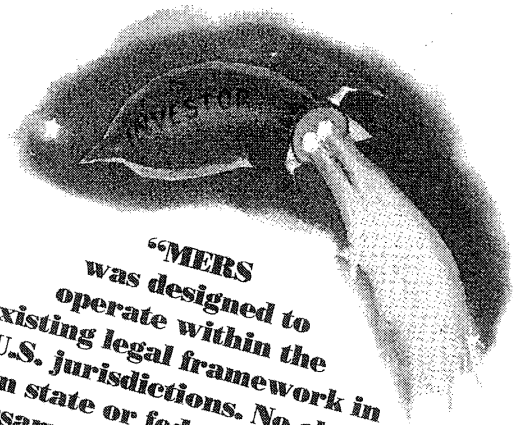
MERS keeps track of the new servicer electronically and acts as nominee for the servicing companies and investors. Because MERS remains the mortgagee of record in the public land records throughout the life of a loan, it eliminates the need to record later assignments in the public land records. Usually, legal title to the property is not affected again until the loan is paid and the mortgage is released. Foreclosures can be done in the name of MERS without the need to reassign the mortgage. Estimates are that MERS will save the mortgage industry $200 million a year by eliminating the need for many assignments. Because MERS should decrease the cost of servicing transfers, mortgage loan portfolios may begin to reflect a price difference if the loans are MERS-registered.

The corporate securities industry created its own book-entry system with the formation of the Depository Trust Company in the 1970s. Another company, the Participant's Trust Company, did the same thing for mortgage-backed securities in the 1980s. These systems revolutionized the way securities are traded. MERS will now play a similar role for mortgage loans.

As a result, consumers will benefit from MERS. The instant accuracy and 1-800 telephone access make it possible for homeowners to verify the validity of hello/goodbye letters. The public land records do not offer that capability because of the lag time between a servicing transfer and recordation of an assignment in the land records. Even more important, title agents can use MERS to find the correct servicer for a particular mortgage loan. That information will allow title agents to obtain accurate payoff information more easily, making loan closings more efficient. In fact, the title industry may benefit from MERS as much as the mortgage industry. MERS will simplify the chain of title because there will be no subsequent assignments to contend with after MERS becomes the mortgagee.

Why Does MERS Work?

MERS was designed to operate within the existing legal framework in all U.S. jurisdictions. No change in state or federal law is necessary. Activity on the MERS System does not affect legal title to land. MERS does not create electronic assignments; it eliminates the need for subsequent assignments altogether. After MERS becomes mortgagee, there are no more assignments, except on the rare occasion when a member wants an assignment from MERS. In that case, the assignment from MERS would be recorded in the public land records and would have the effect of de-registering the loan.



"MERS was designed to operate within the existing legal framework in all U.S. jurisdictions. No change in state or federal law is necessary. Activity on the MERS System does not affect legal title to land. MERS does not create electronic assignments; it eliminates the need for subsequent assignments altogether."

The MERS concept involves three basic legal principles already in use in countless transactions all over the country. MERS simply applies these basic principles in combination to create an electronic book-entry system for mortgage servicing rights.

First, every state provides a mechanism for lenders to secure loans by taking an interest in real estate—most commonly, mortgages and deeds of trust.

Second, every state designates certain places where mortgages or deeds of trust must be recorded to be valid against a bona fide purchaser (BFP). That place is typically with the county recorder or clerk, although sometimes other local officials play this role. Under the U.S. Bankruptcy Code, a bankruptcy trustee occupies the position of a hypothetical BFP. Lenders therefore must perfect their interest properly according to state law or risk losing to the trustee if the homeowner files bankruptcy. 11 U.S.C. § 544(a)(3).

Third, every state permits a person or entity to hold legal title in the public land records as nominee for another person or entity that is the true party in interest. See, e.g., *American Bank &*

Zane invites you to attend a Free Conference on Automating your Trust and Estate practice.

7/8 New York NY
7/8 Newark NJ
7/9 Stamford CT
7/9 Hartford CT
7/10 Boston MA
7/10 Providence RI
9/15 Milwaukee WI
9/16 Minneapolis MN
9/16 St. Paul MN
9/17 Chicago IL

Call:
1-800-331-2533
To Register or Receive Additional Information

ZANE

The Leader In Trust and Estate Administration & Tax Software

Trust Co. v. Louisiana Savings Ass'n, 386 So. 2d 96 (La. Ct. App. 1980). Without that important similarity, the secondary mortgage market might never have grown to its present size. Without nominees, investors could be forced to service loans themselves directly, a highly specialized activity best done by servicing companies, or at least to operate their own mailrooms to forward legal process to the servicers.

Of course, many state laws are dissimilar. Nevertheless, even those laws generally tend to fall into major categories that can be addressed in about the same way. For example, although every state provides for some type of foreclosure if a mortgage is not paid, each has its own procedures. MERS will operate within those local procedural requirements. MERS members presumably already comply with the law in those states where they do business. Those same members are responsible to MERS for ensuring that they continue to comply with those laws after a loan is registered. The important point is that MERS is bound by the laws of the state where the property is located, just as any mortgagee would be; MERS will comply with those laws through its members.

What About County Recorders?

Representatives of the two principal county recorder trade organizations, the National Association of County Recorders and Clerks and the International Association of County Recorders, Election Officials and Treasurers, have served on the MERS Advisory Council since its inception. Generally, county recorders have been far more supportive than some would believe. Most run automated operations, and many are keenly interested in new technology.

Although many are comfortable with MERS, some oppose it. Some recorders have expressed concerns that MERS will eliminate their offices nationwide or destroy the public land records by breaking the chain of title. As implemented, MERS will not create a break in the chain of title, and, because MERS is premised on an assignment recorded in the public land records, MERS cannot work without county recorders. MERS members are satisfied that it works and are trusting MERS to act as the mortgagee for their loan portfolios. The county recorders' real concern appears to be loss of assignment revenues. Whether their assignment revenues will drop remains an open question.

Conclusion

Change defines the future. Advancements in technology have made MERS possible. MERS presents a dramatic change in mortgage loan practices. Adjusting to that change may not be as difficult as it first appears. Moreover, this change should ultimately benefit lenders, title insurers, consumers and their counsel.

How will MERS evolve as it explores the new world of electronic mortgage registration? In whatever direction its members want it to go. MERS is owned and operated by and for the mortgage industry. Right now, the focus is on single-family first mortgages. The next step could be second mortgages. Multi-family or commercial mortgage loans might follow in the future. Almost any secured real estate transaction is a candidate for life on MERS.

R. K. Arnold is Senior Vice President, General Counsel and Secretary of Mortgage Electronic Registration Systems, Inc. in McLean, Virginia.

Announcing...

Valuation Rules Under Chapter 14

The Impact on Gift and Estate Taxation

by Louis A. Mezzullo

For lawyers, life underwriters, accountants, trust officers, and financial planners

To help you master valuation planning and to educate you on the recent developments of Chapter 14, *Valuation Rules Under Chapter 14* provides you with the groundwork to understand the intricacies of Chapter 14 and alerts you to the valuation rules affecting your client's estate plan.

MINIMIZE YOUR CLIENT'S ESTATE AND GIFT TAX LIABILITIES

Valuation Rules Under Chapter 14 is your first step to understanding the new rules under Chapter 14. You will eliminate hours of research time by getting the most up-to-date information on statutes and regulations affecting Chapter 14. This guide helps you:

- determine whether a particular transaction is covered by Chapter 14, and if so, the consequences that result from its application;
- achieve your clients' estate planning goals and minimize their estate and gift taxes;
- understand the valuation rules to determine the value for gift tax purposes;
- differentiate between nongift transfers and transfers treated as gifts; and
- understand the aspects of valuation rules and the important exceptions to the rules.

CHAPTER 14 AFFECTS ALMOST ALL ESTATE PLANNING TECHNIQUES

Designed for every professional involved in estate planning, *Valuation Rules Under Chapter 14* offers practical advice that may apply to almost any estate planning technique or arrangement. You will learn:

- transfers of interests in corporations and partnerships having more than one class of equity;
- transfers of interest in trusts and similar arrangements;
- buy-sell agreements, options, and other restrictions on the right to use or transfer property;
- lapsing voting and liquidation rights; and
- restrictions on the right to liquidate an interest in a partnership or corporation.

EXAMPLES AND PLANNING POINTERS

This comprehensive guide contains useful examples that outline every aspect of valuation planning under Chapter 14. Written in user friendly language, the examples and planning pointers will help you take full advantage of planning opportunities to reduce transfer taxes for your client's estate plan.

October 1995 8 ½ x 11 208 pages paper

Yes, please send me:

ABA

MAIL TO:
American Bar Association
Publication Orders
P.O. Box 10892
Chicago, IL 60610-0892
PHONE: 312/988-5522
FAX: 312/988-5568
E-mail:
abasvcctr@attmail.com

_____ copies of *Valuation Rules Under Chapter 14* (5430367) @ [ ] $64.95 RP Section member price
[ ] $69.95 regular price

$_____ Subtotal

$_____ Tax (DC–5.75%, IL–8.75%, MD–5%)

$ 5.95 Handling [ ] Check enclosed payable to the ABA

$_____ Total [ ] Bill me [ ] VISA [ ] MasterCard [ ] American Express

Acct.#_____ Exp.Date_____ Signature_____

Name_____ Firm/Org_____

Address_____

City/State/ZIP_____ Phone number ( ) _____
(in case we have a question about your order)

Allow 1-2 weeks for delivery. Thank you for your order.

PP697

APPENDIX A.2

FILED ENTERED
LODGED RECEIVED
OCT 14 2011
AT SEATTLE
CLERK U.S. DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON DEPUTY
BY

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

BERNARD R. CORALES, et al.,

Plaintiffs,

v.

FLAGSTAR BANK, FSB, et al.,

Defendants.

CASE NO. C10-1922JLR

ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

Before the court are Defendants Flagstar Bank, FSB's ("Flagstar") and Mortgage Electronic Registration System, Inc.'s ("MERS") motion for summary judgment (Dkt. # 48) and Defendant Northwest Trustee Services, Inc.'s ("NWTS") motion to dismiss the amended complaint with prejudice (Dkt. # 53). Having reviewed the motions, all papers filed in support and opposition thereto, and the applicable law, the court GRANTS

10-CV-01922-ORD

Flagstar's and MERS's motion for summary judgment and also GRANTS NWTS's motion to dismiss.[1]

II. FACTUAL AND PROCEDURAL BACKGROUND

On May 21, 2008, Plaintiff Bernard R. Corales borrowed $240,000 by executing a note in favor of Axia Financial, LLC ("Axia"). (Am. Compl. (Dkt. # 37) ¶ 23; 2nd Cruz Decl. (Dkt. # 50) Ex. A (attaching copy of the Note).) Axia subsequently sold Plaintiffs' Note to Flagstar, endorsing the Note directly to Flagstar. (*Id.* Ex. A at 4.) Flagstar continues to hold the Note, and has since endorsed it in blank, rendering the Note bearer paper. (*Id.* at 5.)

Plaintiffs Bernard R. Corales and Maria Corales secured the debt with a Deed of Trust on their property commonly described at 4092 Letitia Avenue, Seattle, Washington ("the Property"). (*Id.* Ex. B (attaching a copy of the Deed of Trust).) The Deed of Trust names Joan H. Anderson, EVP on behalf of Flagstar, as the trustee and grants the trustee the power of sale in the event of default. (*Id.*)

Although Axia was the lender, the parties agreed in the Deed of Trust to designate MERS as the beneficiary, "acting solely as nominee for Lender and Lender's successors and assigns." (*Id.*) The Deed of Trust states that "MERS holds only legal title to the interests granted" by the Deed of Trust, and that MERS "has the right to exercise any or all of those interests." (*Id.*) On or about April 30, 2010, MERS, as beneficiary under the Deed of Trust and nominee for Axia, executed an Assignment of the Deed of Trust

[1] No party requested oral argument with regard to either motion, and the court finds oral argument to be unnecessary as well.

("Assignment") transferring all beneficial interest in the Deed of Trust to Flagstar. (Am. Compl. Ex. D; Mot. to Dismiss (Dkt. # 53) at 2, Ex. B (attaching true and correct copy of the Assignment).)

In February 2009, nine months after Mr. Corales signed the Note, Plaintiffs stopped making payments and defaulted on the Note. (Morgan Decl. (Dkt. # 51) ¶ 2, Ex. A ("Payoff Demand Schedule"); 1st Cruz Decl. (Dkt. # 15) Ex. E ("Notice of Trustee's Sale").) In March 2009, Mr. Corales sent a letter to his "Home Mortgage Lender" apologizing for not making his February 2009 mortgage payment. (*Id.* Ex. F.) In the letter, he explains that he lost his job in October 2008, and has been unable to find a new one. (*Id.*) After Plaintiffs' default, Flagstar initiated nonjudicial foreclosure proceedings. However, as described below, those proceedings have been continued due to this lawsuit and Plaintiffs' various bankruptcy filings.

On or about May 19, 2010, Flagstar executed an Appointment of Successor Trustee ("Appointment") naming NWTS as Successor Trustee and vesting NWTS with all powers of the original trustee. (*See* Am. Compl. Ex. E; Mot. to Dismiss at 3, Ex. C (attaching true and correct copy of the Appointment).) On or about June 7, 2010, NWTS executed a Notice of Trustee Sale ("Notice"), which set a sale date for the Property of September 10, 2010. (*See id.*, Ex. D (attaching true and correct copy of the Notice).)

Plaintiffs filed this action on November 29, 2010. (Compl. (Dkt. # 1).) In early January 2011, Plaintiffs also filed a bankruptcy petition. (*See* Not. of Bankr. (Dkt. # 10); *In re: Bernard R. Corales,* No. 11-10142-SJS (W.D. Wash. Bankr.), Chapter 13 Voluntary Petition (Dkt. # 1); Mot. to Dismiss at 3, Ex. F.) Plaintiffs voluntarily

dismissed this Chapter 13 bankruptcy a few weeks later. (*See id.*; Mem. Resp. to OSC (Dkt. # 13) ¶ 3.)

On February 10, 2011, Flagstar moved for summary judgment on all of Plaintiffs' claims. (1st SJ Mot. (Dkt. # 14).) On February 25, 2011, NWTS executed an Amended Notice of Trustee's Sale ("Amended Notice"), which set a sale date for the Property of April 15, 2011. (*See* Am. Compl. Ex. F; Mot. to Dismiss at 3, Ex. E (attaching true and correct copy of Amended Notice).) On April 4, 2011, more than a month after the parties had completed briefing on Flagstar's motion for summary judgment, Plaintiffs asked the court to dismiss their claims so they could re-file them in bankruptcy court. (Not. of Vol. Dismissal (Dkt. # 29).)

On April 26, 2011, the court denied Plaintiffs' motion for voluntary dismissal, affording them instead the opportunity to "amend their complaint to bring it into compliance with the Federal Rules of Civil Procedure and appropriate Supreme Court precedents." (Order (Dkt. # 36) at 6.) The court also struck Flagstar's pending motion for summary judgment without prejudice to re-filing if appropriate following the filing of Plaintiffs' amended complaint. (*Id.*) Significantly, the court also stated that it appeared "that Plaintiffs [we]re attempting to use the federal courts as a tool to improperly delay adjudication of issues . . . before the court." (*Id.* at 5.)

In the meantime, however, on April 13, 2011, just two days before the scheduled nonjudical foreclosure sale of the Property, Plaintiffs again filed for Chapter 13 bankruptcy. (*See* Mot. to Dismiss at 3, Ex. G; *In re: Bernard R. Corales,* No. 11-14237-TWD (W.D. Wash. Bankr.), Chapter 13 Voluntary Petition (Dkt. # 1).) On June 9, 2011,

the bankruptcy court dismissed the petition for failure to file the required schedules. (*Id.* Bankr. Order (Dkt. # 15).)

On May 5, 2011, Plaintiffs filed a "Verified Amended Complaint" seeking fundamentally different relief than their original complaint. (*See* Am. Compl. (Dkt. # 37).) In this verified amended complaint, Plaintiffs state on penalty of perjury that "[o]n or about May 21, 2011, Plaintiff executed a Note and Deed of Trust for the sum of $240,000 in favor of [Axia]." (*Id.* ¶ 23 (underlining in original).) In addition, Plaintiffs also admit that "[t]he Deed of Trust names Defendant MERS as 'nominee' and as a 'beneficiary'." (*Id.*)

On June 7, 2011, Mr. Corales filed an "Emergency Affidavit." (Corales Aff. (Dkt. # 45).) In the affidavit, in direct contravention to his sworn statement in the verified amended complaint, Mr. Corales states that he "dispute[s] the authenticity of the purported Note . . . , [and] dispute[s] that the purported Note bears [his] signature . . . ." (*Id.* ¶ 11.) In contravention to his March 2009 letter to Flagstar, he also denies that he defaulted on the Note. (*Id.*)

On June 16, 2011, Flagstar filed its second motion for summary judgment seeking dismissal of all of Plaintiffs' claims contained within its verified amended complaint. (2nd SJ Mot. (Dkt. # 48).) On July 7, 2011, NWTS filed a motion to dismiss with prejudice Plaintiffs' claims against it. (Mot. to Dismiss (Dkt. # 53).) On July 21, Plaintiffs filed a motion to amend their amended complaint. (Mot. to Amend (Dkt. # 59).) The court denied Plaintiffs' motion to amend on October 11, 2011. (Oct. 11, 2011

Order (Dkt. # 74).) The court now considers Flagstar's and MERS's motion for summary judgment and NWTS's motion to dismiss Plaintiffs' claims with prejudice.

III. ANALYSIS

A. Standards

NWTS has brought a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) with regard to the claims Plaintiffs have alleged against it in their amended verified complaint. (Mot. to Dismiss at 1.) When considering a motion to dismiss under Rule 12(b)(6), the court construes the complaint in the light most favorable to the non-moving party. *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005). The court must accept all well-pleaded allegations of material fact as true and draw all reasonable inferences in favor of the plaintiff. *See Wyler Summit P'ship v. Turner Broad. Sys.*, 135 F.3d 658, 661 (9th Cir. 1998). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, --- U.S. ---, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)); *see Telesaurus VPC, LLC v. Power*, 623 F.3d 998, 1003 (9th Cir. 2010). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. Dismissal under Rule 12(b)(6) can be based on the lack of a cognizable legal

theory or the absence of sufficient facts alleged under a cognizable legal theory. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990).[2]

Flagstar and MERS have moved for summary judgment of all claims against them in Plaintiffs' verified amended complaint. (*See* 2nd SJ Mot.) Summary judgment is appropriate if the evidence, when viewed in the light most favorable to the non-moving party, demonstrates "that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *see Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986); *Galen v. Cnty. of L.A.*, 477 F.3d 652, 658 (9th Cir. 2007). The moving party bears the initial burden of showing there is no genuine issue of material fact and that he or she is entitled to prevail as a matter of law. *Celotex*, 477 U.S. at 323. If the moving party meets his or her burden, then the non-moving party "must make a showing sufficient to establish a genuine dispute of material fact regarding the existence of the essential elements of his case that he must prove at trial" in order to withstand summary judgment. *Galen*, 477 F.3d at 658.

However, "[t]he mere existence of a scintilla of evidence in support of the non-moving party's position is not sufficient" to meet the burden and one cannot oppose a properly supported summary judgment motion by "rest[ing] on mere allegations or denials of his pleadings." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986).

---

[2] Because Mr. and Ms. Corales are proceeding *pro se*, the court must construe their complaint liberally even when evaluating it under the *Iqbal* standard. *Johnson v. Lucent Techs., Inc.*, --- F.3d ---, 2011 WL 3332368, at *9 (9th Cir. Aug. 19, 2011). Furthermore, "[l]eave to amend should be granted unless the pleading could not possibly be cured by the allegation of other facts, and should be granted more liberally to pro se plaintiffs." *Id.* (quoting *McQuillion v. Schwarzenegger*, 369 F.3d 1091, 1099 (9th Cir.2004) (internal quotation marks omitted)).

Without specific facts to support the conclusion, a bald assertion of the "ultimate fact" is insufficient. *See Schneider v. TRW, Inc.*, 938 F.2d 986, 990-91 (9th Cir. 1991). Genuine factual issues must exist that "can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Anderson*, 477 U.S. at 250. If the non-moving party fails to make a sufficient showing of an element of its case, the moving party is entitled to judgment as a matter of law. *Celotex*, 477 U.S. at 325.

B. Flagstar's and MERS's Motion for Summary Judgment

1. Alleged Securitization of Plaintiffs' Loan

In their verified amended complaint, Plaintiffs allege that Flagstar "transferred" their loan into a mortgaged-backed security fund related to Fannie Mae. (*See* Am. Compl. ¶ 24 & Ex. C.) However, even assuming that Plaintiffs' allegations are true, they have not established that Flagstar presently lacks authority to enforce the Deed of Trust at issue or that Flagstar lacks authority to initiate foreclosure proceedings. It is undisputed that Flagstar is in possession of the original Note at issue, endorsed in blank. Flagstar therefore is the holder of the Note with the right to enforce it and the corresponding Deed of Trust. *See* RCW 62A.3-205 ("holder of an instrument" is entitled to enforcement); *Fidel v. Deutsche Bank Nat. Trust Co.*, No. C10-2094RSL, 2011 WL 2436134, at *3 (June 14, 2011) ("[D]efendant has provided the Note, which was endorsed to defendant and is currently in defendant's possession. Accordingly, defendant has the authority to institute foreclosure proceedings.") (citing RCW 61.24.005 (defining "beneficiary" as the "holder of the instrument or document evidencing the obligations secured by the deed of trust")).

In a similar case, a federal bankruptcy judge recently rejected precisely Plaintiffs' argument, holding that even if a lender sells a loan to Fannie Mae, the lender's possession of the Note endorsed in blank means that it may foreclose in its own name. *In re Martinez*, --- B.R. ---, 2011 WL 1519877, at * 5 & n. 44 (Bankr. D. Kan. Apr. 20, 2011) (even assuming lender sold Note to Fannie Mae, "the note would still be in [the lender's] possession and would be endorsed in blank – again making it a holder in possession of the note entitled under the [Uniform Commercial Code] to enforce it against Plaintiff."); *see also In re Veal*, 450 B.R. 897, 912 (B.A.P. 9th Cir. 2011) ("[T]he maker [of the Note] should be indifferent as to who owns or has an interest in the note so long as it does not affect the maker's ability to make payments on the note. Or, . . . [the plaintiff] should not care who actually owns the Note—and it is thus irrelevant whether the Note has been fractionalized or securitized—so long as they do know who they should pay."). Thus, even if Fannie Mae has an interest in Plaintiffs' loan, Flagstar has the authority to enforce it. Thus, the court grants Flagstar's and MERS's motion with regard to this issue.

2. MERS's Authority to Act as a Beneficiary

Although Plaintiffs' allegations are somewhat unclear, they appear to be asserting that MERS was not a proper beneficiary under the Deed of Trust and thus could not assign its beneficial interest. (*See* Am. Compl. ¶¶ 34-37.) Plaintiffs, however, have admitted that they signed a Deed of Trust that acknowledged that MERS was a beneficiary under the deed and that MERS had the right to foreclose and sell property covered by the deed. (*See* Am. Compl. ¶ 23 ("On or about May 21, 2008, Plaintiff executed a Note and Deed of Trust . . . . The Deed of Trust names Defendant MERS as a

'nominee' and as a 'beneficiary'") & Ex. B at 3 ("Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right to exercise any or all of those interests, including but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and cancelling this Security Instrument.").)

This court has repeatedly rejected the argument that MERS is not a proper beneficiary under a Deed of Trust where the plaintiff has executed a deed which expressly acknowledges MERS's status as a beneficiary. *See, e.g., St. John v. Northwest Trustee Servs., Inc.*, No. C11-5382BHS, 2011 WL 4543658, at *2-*3 (W.D. Wash. Sept. 29, 2011); *Rhodes v. HSBC Bank USA, N.A.*, No. C11-5303RJB, 2011 WL 3159100, at *3-*4 (W.D. Wash. July 26, 2011) ("MERS had the authority to act as beneficiary under a Deed of Trust where such authority was explicitly granted by plaintiff upon execution of the instrument."); *Ceburn v. HSBC Bank USA, N.A.*, No. C10-5742BHS, 2011 WL 321992, at *3 (W.D. Wash. Feb. 2, 2011); *Vawter v. Quality Loan Serv. Corp. of Wash.*, 707 F. Supp. 2d 1115, 1125-26 (W.D. Wash. 2010); *Moon v. GMAC Mortgage Corp.*, No. C08–969Z, 2008 WL 4741492, at *5 (W.D. Wash. Oct.24, 2008).[3] Accordingly, the court grants Flagstar's and MERS's motion with regard to this issue.

---

[3] Judge Coughenour of this court recently certified three questions on this subject to the Washington Supreme Court. (*See Bain v. Metropolitan Mortg.*, Cause No. C09-0149JCC (W.D. Wash.) "Order Certifying Questions to the Washington Supreme Court" (Dkt. # 159).) Judge

3. Flagstar's Authority to Foreclose

Plaintiffs also appear to be claiming that Flagstar has no authority to foreclose on the property because MERS did not properly record or convey its beneficial interest in the Deed of Trust to Flagstar, and therefore any nonjudicial foreclosure proceeding by Flagstar against them is void. (*See* Am. Compl. ¶¶ 36 & 41(b).) As discussed above, MERS is a proper beneficiary under the Deed of Trust here, and validly assigned its interest under Plaintiffs' Deed of Trust to Flagstar. Moreover, Washington State does not require the recording of such transfers and assignments. *See St. John*, 2011 WL 4543658, at * 3 (citing RCW 61.24.005(2) (defining Beneficiary as the "the holder of the instrument of document evidencing the obligations secured by the deed of trust"); *see also, e.g., In re United Home Loans*, 71 B.R. 885, 891 (Bankr. W.D. Wash. 1978), *aff'd*, 876 F.2d 897 (9th Cir. 1989) ("An assignment of a deed of trust . . . is valid between the parties whether or not the assignment is ever recorded. . . . Recording of the assignments is for the benefit of the parties. . . .") (internal citations omitted.). The purpose of recording the assignment is to put parties who subsequently purchase an interest in the property on notice of which entity owns a debt secured by the property. RCW 65.08.070. Therefore, Plaintiffs claim based on an alleged lack of recording of the assignment from

---

Coughenour has also stayed at least two cases pending resolution of the certified questions. *See Dean v. Aurora Bank, F.S.B.*, No. C11-05339 RBL, 2011 WL 3812653, at * 2 (W.D. Wash. Aug. 29, 2011). However, in light of the overwhelming number of decisions from the Western District of Washington upholding the role of MERS in the factual circumstances similar to those at issue here (cited above), the court finds no reason to similarly stay this action.

MERS to Flagstar is unavailing, and the court grants summary judgment to Flagstar and MERS with regard to this issue.

4. **Plaintiffs Are in Default**

Flagstar and MERS are also seeking summary judgment with regard to Plaintiffs' default on the Note, and Flagstar's consequent right to initiate foreclosure proceedings. (2nd SJ Mot. at 11-14.) Flagstar has submitted evidence detailing Plaintiffs' default. (*See* 1st Cruz Decl. ¶ 6 Exs. E (attaching Notice of Trustee's Sale); 2nd Cruz Decl. ¶ 4, Ex. C; Morgan Decl. (Dkt. # 51) ¶ 2, Ex. B (attaching June 8, 2011 Payoff Demand Statement for Plaintiffs' loan, and identifying February 1, 2009 as the date of Plaintiffs' default).) In addition, Flagstar has submitted evidence that Mr. Corales sent a letter to his "Home Mortgage Lender," dated March 20, 2009, in which he apologizes for and admits failing to make his mortgage payment. (1st Cruz Decl. ¶ 7, Ex. F.) Mr. Corales has never disavowed this letter in any of his many filings with this court. Nor have Plaintiffs ever submitted any evidence of timely payment on the Note to contradict or create a materail issue of fact with regard to the evidence of default submitted by Flagstar.

In addition, Plaintiffs have explicitly admitted, under penalty of perjury, signing the Note and the Deed of Trust at issue here. On May 10, 2011, in their verified amended complaint, Plaintiffs state: "On or about May 21, 20008, Plaintiff executed a Note and Deed of Trust for the sum of $240,000 in favor of AXIA FINANCIAL, LLC." (Am. Compl. ¶ 23 (underlining and capitalization in original).)

Yet, less than a month later, on June 7, 2011, Mr. Corales filed an "emergency affidavit" with the court, in which he flatly contradicts his previous sworn statement by

"disput[ing] that the purported Note bears [his] signature." (Corales Aff. ¶ 11. He also contradicts his prior to letter to Flagstar by stating that he "den[ies] that [he] defaulted on the purported Note." (*Id.*; *see also id.* ¶ 3 ("I . . . deny that I have defaulted on the subject loan. . . .").) Once again, however, Mr. Corales submits no documentary or other evidence of timely payment on the Note to back up his bald assertion denying default.

In the Ninth Circuit, the "sham affidavit rule" prevents a party from creating an issue of material fact by introducing an affidavit that contradicts prior deposition testimony. *Kennedy v. Allied Mutual Ins. Co.*, 952 F.2d 262, 266-67 (9th Cir. 1991). Courts have extended this rule to apply to affidavits that contradict a party's prior admission. *See Container Recovery, Inc. v. Shasta Nw., Inc.*, No. 05-1749-PK, 2007 WL 1724937, at * 6 (D. Or. June 11, 2007). Nevertheless, the rule is in tension with the principle that a court's role in deciding a motion on summary judgment is not to make credibility determinations or to weigh evidence. *Van Asdale v. Int'l Game Tech*, 577 F.3d 989, 998 (9th Cir. 2009). Therefore, the rule should be applied with caution. Inconsistencies in a party's statements must be clear and unambiguous to justify striking an affidavit. *Id.*

Here, the court has no difficulty finding that Mr. Corales's "emergency affidavit" is a sham. The statements quoted above in Mr. Corales's "emergency affidavit" are not minor inconsistencies or clarifying testimony. They are in direct contradiction to Plaintiffs' prior sworn statements in their verified amended complaint concerning execution of the Note at issue, as well as to the admissions Mr. Corales previously made

to Defendants concerning his default.[4] Accordingly, the court strikes Mr. Corales's "emergency affidavit" as a sham, and will not consider it in rendering its decision on Flagstar's and MERS's motion for summary judgment.

As a result of the court's finding, there is no evidence in contravention of Plaintiffs' default on the Note, and thus no material issue of fact with regard to default for trial. Accordingly, the court grants Flagstar's and MERS's motion for summary judgment with regard to Plaintiffs' default on the Note at issue.

5. Axia's Alleged Failure to Disclose and RESPA

Plaintiffs claim that they "are uncertain as to their rights under the Note and Deed of Trust" because Axia "failed to disclose all affiliated business arrangements" at their loan's origination. (Am. Compl. ¶ 37.) Plaintiffs appear to seek monetary damages for Axia's alleged failure to comply with the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2601, *et seq*. Plaintiffs, however, do not allege that Flagstar or any other Defendant played any role in Axia's extension of credit to Plaintiffs. (*See generally* Am. Compl.) Defendants therefore cannot be held liable for Axia's alleged failure to comply with RESPA. RESPA uses the definition of "creditor" that is found in the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601, et seq. *See* 12 U.S.C. § 2602(1)(B)(iv) (defining "creditor consistent with the definition found in 15 U.S.C. §

---

[4] The court's finding here is bolstered by its previous finding (when it denied Plaintiffs' motion for voluntary dismissal) that it appeared that "Plaintiffs [we]re attempting to use the federal courts as a tool to improperly delay adjudication of issues . . . before the court." (April 26, 2011 Order at 5.) Further, the court cautions Plaintiffs that intentionally making false statements under oath to a court of law can result in prosecution for perjury.

1602(f)). TILA defines a "creditor," in part, as "the person to whom the debt . . . is initially payable on the face of the evidence of the indebtedness . . . ." 15 U.S.C. § 1602(f). Plaintiffs' debt was initially payable to Axia. Accordingly, no Defendant is Plaintiffs' "creditor" under either TILA or RESPA.

In addition, even if Plaintiffs could bring a RESPA claim against Flagstar or MERS (or any other Defendant) for Axia's alleged failure to disclose its affiliated business arrangements, RESPA's one-year statute of limitations has lapsed. The requirement to disclose affiliated business arrangements is governed by section 2607 of RESPA. 12 U.S.C. § 2607(c)(4). Claims under section 2607 must be brought within one year of the alleged violation. 12 U.S.C. § 2614. Plaintiffs' loan closed in May 2008 (1st Cruz Decl. Ex. A.) Plaintiffs did not file suit until November 29, 2010. (*See* Compl.) Thus, Plaintiffs' RESPA claim is time barred. The court grants summary judgment to Flagstar and MERS with regard to this claim.

6. Declaratory or Injunctive Relief

Plaintiffs allege that they are entitled to declaratory or injunctive relief based on the underlying allegations in their amended complaint, and ask the court to enjoin the trustee's sale of the Property. (Am. Compl. ¶¶ 38-41.) Because the court has granted summary judgment to Flagstar and MERS with regard to the substance of Plaintiffs' underlying claims, Plaintiffs are not entitled to declaratory or injunctive relief either. *See*

RCW 61.24.130 (setting out requirements for injunctive relief in the case of a trustee's nonjudicial foreclosure sale).[5]

7. New Claims Raised in Response to Summary Judgment Motion

In response to Flagstar's and MERS's motion for summary judgment, Plaintiffs assert new claims not plead in their amended complaint. For example, Plaintiffs assert that the Note at issue here is a security under the Securities Act of 1933 (*see* Resp. (Dkt. # 52) at 2, 8-9, 11), that Flag star is subject to the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. § 1692g, *et seq.* (*see id.* at 2, 4), and that Axia's endorsement of the Note "without recourse" somehow "materially altered" the Note rendering it unenforceable (*id.* at 4-6).[6] It is improper for Plaintiffs to raise these claims in response to a summary judgment motion, after the deadline for amending pleadings has passed (*see* Sched. Ord. (Dkt. # 24) at 1), and without a showing of good cause pursuant to Federal Rule of Civil Procedure 16(b)(4). Nonetheless, in recognition of Plaintiffs' *pro se* status, the court will briefly address these additional "claims."

---

[5] Further, RCW 61.24.130(1) requires, as a condition of injunctive relief, "that the applicant pay to the clerk of the court the sums that would be due on the obligation secured by the deed of trust if the deed of trust was not being foreclosed." There is no evidence on the record that Plaintiffs are capable of making the required payments to the clerk of court which is a statutory prerequisite to injunctive relief here.

[6] While none of these claims are alleged in Plaintiffs' amended complaint (*see generally* Am. Compl.), some of these claims may be alleged (although not adequately so) in Plaintiffs' proposed second amended complaint. (*See* Prop. 2nd Am. Compl. (Dkt. # 59-1) at ¶¶ 24, 28.) The court, however, has denied Plaintiffs' motion for leave to amend its amended complaint and to file a second amended complaint. (Oct. 11, 2011 Order (Dkt. # 74).) Accordingly, the operative complaint here is Plaintiffs' verified amended complaint. (*See generally* Am. Compl.)

The Supreme Court has expressly stated that a "note secured by a mortgage on a home" is "not properly viewed as [a] security[y]" under the Securities Act of 1933. *Reves v. Ernst & Young,* 494 U.S. 56, 65 (1990). There is no dispute that Plaintiffs' Note is secured by a deed of trust on their home. As such, the Securities Act of 1933 is not applicable here. *See also Cowen v. Aurora Loan Servs.*, No. CIV 10-452-TUC-CKJ, 2010 WL 3342196 (D. Ariz. Aug. 25, 2010) ("Plaintiffs have failed to allege any facts that would make a promissory note and deed of trust involving real estate subject to either the Securities Act of 1933 or the Exchange Act of 1934.")

"The trend among Ninth Circuit District Courts has been to hold that enforcement of a security interest through a nonjudicial foreclosure proceeding does not constitute the collection of a debt" under the FDCPA. *Thepvongsa v. Reg'l Trustee Servs. Corp.*, No. C10-1045 RSL, 2011 WL 307364, at *8 (W.D. Wash. Jan. 26, 2011); *see also Litgon v. JP Morgan Case Bank,* No. C 11-2504 MEJ, 2011 WL 2550836, at *3 (N.D. Cal. June 27, 2011) (collecting cases); *Fong v. Prof'l Foreclosure Corp.*, No. C05-448JLR, 2005 WL 3134059, at * 2 (W.D. Wash. Nov. 22, 2005) ("Notably, Washington's Deed of Trust Act provides that a foreclosure action constitutes enforcement of an interest in property via a trustee's sale."). The court notes, however, that there is countervailing authority in both in the Fourth and Fifth Circuits. *See Wilson v. Draper & Goldberg, P.L.L.C.*, 443 F.3d 373, 376 (4th Cir. 2006) and *Kaltenbach v. Richards*, 464 F.3d 524, 529 (5th Cir. 2006).

In any event, even if the FDCPA were generally applicable to nonjudicial foreclosure proceedings, it would not be applicable here because Flagstar acquired its

interest in the Note before Plaintiffs defaulted on their obligation. Flagstar committed to purchase Plaintiffs' loan on May 17, 2008, took possession of the Note on May 27, 2008, paid for the Note on June 5, 2008, and has remained in possession ever since. (Daly Decl. (Dkt. # 55) ¶ 2.) Plaintiffs were not in default of their loan until February 1, 2009. (Morgan Decl. (Dkt. # 51) ¶ 2.) Accordingly, Plaintiffs cannot state a plausible claim under the FDCPA because the FDCPA does not apply to lenders acquiring debt before default. *See De Dios v. Int'l Realty & Inv.*, 641 F.3d 1071, 1074 (9th Cir. 2011).

Finally, Plaintiffs assert Axia's endorsement of the Note "without recourse" somehow "materially altered" the Note rendering it unenforceable. (Resp. at 4-6). By endorsing the Note "without recourse," Axia was merely insulating itself from liability with regard to any subsequent Note holders should Plaintiffs default on the Note. *See Hall v. Sec. Planning Serv. Inc.*, 371 F. Supp. 7, 14 (D. Ariz. 1974) ("An indorsement of a note creates a contract (unless without recourse) binding indorser to pay the instrument according to its tenor at time of indorsement to holder."). Plaintiffs offer no authority for their novel and somewhat perplexing argument. Indeed, if the court were to follow Plaintiffs argument to its logical conclusion, then any endorsement of a negotiable instrument "without recourse" would render the instrument invalid. Axia and Flagstar endorsed the Note without recourse to effect the Note's negotiation. The endorsements "without recourse" by either Axia or Flagstar in no way altered Plaintiffs' obligations under the Note. None of the new claims or arguments Plaintiffs assert in response to Flagstar's and MERS's motion for summary judgment, even if permissible at this stage in

the litigation, raise material issues of fact warranting a trial. Accordingly, the court grants Flagstar's and MERS's motion for summary judgment.

C. NWTS's Motion to Dismiss

Although it is difficult to discern precisely what claims Plaintiffs assert in their amended complaint against NWTS, Plaintiffs do not appear to allege any claim against NWTS that differs from their claims against MERS and Flagstar. (*See generally* Am. Compl.) As discussed above, the court has already found these claims lacking on summary judgment. Although the motion for summary judgment was brought by Flagstar and MERS, the court finds no reason why its rulings above should not apply equally with regard to Plaintiffs' indistinguishable claims against NWTS.

Nevertheless, construing Plaintiffs' amended complaint as liberally as possible in light of their *pro se* status, the court finds that they may be attempting to allege that NWTS's appointment as trustee was not valid. Plaintiffs, however, fail to allege any specific facts against NWTS to support this assertion. Their amended complaint is devoid of sufficient factual matter against NWTS to "'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, --- U.S. ---, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007))

Although not alleged in their amended complaint, in response to NWTS's motion, Plaintiffs also baldly assert (1) that NWTS violated Washington's Deed of Trust Act, RCW 61.24, *et seq.*; (2) that NWTS does not have authority to initiate a foreclosure action on the Property; and (3) that NWTS slandered title to the Property. (*See generally* Resp. (Dkt. # 58).) Even assuming that the court were to permit Plaintiffs to plead these

additional claims in response to NWTS's motion to dismiss, they again fail to plead sufficient facts in support of these claims to withstand dismissal under the standards set forth in *Twombly,* 550 U.S. at 557, and *Iqbal,* 129 S.Ct. at 1949. A claim does not suffice if it tenders only "'naked assertion[s]' devoid of 'further factual enhancement.'" *Iqbal,* 129 S.Ct. at 1949 (quoting *Twombly,* 550 U.S. at 557.)

Further, a review of the various publically recorded documents that were submitted by NWTS, and attached to Plaintiffs' amended complaint, supports NWTS's motion to dismiss.[7] Nothing in the Appointment of NWTS as trustee (*see* Am. Compl. Ex. E; Mot. to Dismiss at 3, Ex. C), NWTS's first Notice of Trustee's Sale (*see id.*, Ex. D), or NWTS's Amended Notice of Trustee's Sale (*see* Am. Compl. Ex. F; Mot. to Dismiss at 3, Ex. E) indicate any wrong-doing on the part of NWTS.[8] In face of this documentary evidence, Plaintiffs' bald allegations, devoid of any factual enhancement, cannot withstand NWTS's motion to dismiss. The court, therefore, grants NWTS's motion to dismiss Plaintiffs' claims against it.[9]

---

[7]On a motion to dismiss, the court may consider documents or exhibits attached to Plaintiffs' complaint, a writing of unquestioned authenticity that is relied upon in the complaint, or public records. *Swartz v. KPMG, LLP,* 476 F.3d 756, 763 (9th Cir. 2007) (stating that on motion to dismiss court may consider exhibits attached to the complaint or other documents relied upon in the complaint); *Papasan v. Allain,* 478 U.S. 265, 268 n.1 (1986) ("Although this case comes to us on a motion to dismiss under Federal Rule of Civil Procedure 12(b), we are not precluded in our review of the complaint from taking notice of items in the public record . . . .").

[8] Further, Plaintiffs have never alleged that they failed to timely receive either of the Notices of Trustee's Sale. Indeed, the Property has yet to be sold in foreclosure.

[9] The court has already afforded Plaintiffs an opportunity to amend their complaint. (*See* April 26, 2011 Order at 6; *see also generally* Am. Compl.) In so amending, Plaintiffs were unable to draft a complaint sufficient to withstand Flagstar's and MERS's second motion for

IV. CONCLUSION

Based on the foregoing, the court hereby ORDERS that: (1) Flagstar's and MERS's second motion for summary judgment (Dkt. # 48) is GRANTED; (2) NWTS's motion to dismiss Plaintiffs' claims with prejudice (Dkt. # 53) is GRANTED; (3) Flagstar's and MERS's motion to amend the scheduling order (Dkt. # 66) is DENIED as MOOT; and (4) Plaintiffs' case is DISMISSED for the reasons stated herein.

Dated this 14th day of October, 2011.

JAMES L. ROBART
United States District Judge

---

summary judgment and NWTS's motion to dismiss. In addition, the court recently denied Plaintiffs' motion to amend their amended complaint and file a second amended complaint because they failed to show good cause for their delay in seeking amendment after the scheduling order's deadline for amending pleadings had passed. (*See* Oct. 11, 2011 Order (Dkt. # 74).) The court finds that "[n]o amendment could save these plaintiffs," and granting a further opportunity to amend, even in recognition of Plaintiffs' *pro se* status, would be futile. *See Bell v. City of Kellogg*, 922 F.2d 1418, 1425 (9th Cir. 1991).

APPENDIX A.3

H.R. REP. 101-54(I), H.R. REP. 101-54, H.R. Rep. No. 54(I), 101ST Cong., 1ST Sess. 1989, 1989 U.S.C.C.A.N. 86, 1989 WL 168164 (Leg.Hist.)

**1 P.L. 101–73, *86 FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989

DATES OF CONSIDERATION AND PASSAGE

House: June 15, August 3, 4, 1989

Senate: April 19, June 21, August 3, 4, 1989

House Report (Banking, Finance and Urban Affairs Committee) No. 101–54 (I, III, and VII), May 16, June 1, 8, 1989 (To accompany H.R. 1278)

House Report (Ways and Means Committee) No. 101–54 (II), May 22, 1989 (To accompany H.R. 1278)

House Report (Rules Committee) No. 101–54 (IV), June 1, 1989 (To accompany H.R. 1278)

House Report (Judiciary Committee) No. 101–54 (V), June 1, 1989 (To accompany H.R. 1278)

House Report (Government Operations Committee) No. 101–54 (VI), June 2, 1989 (To accompany H.R. 1278)

Senate Report (Banking, Housing, and Urban Affairs Committee) No. 101–19, Apr. 13, 1989 (To accompany S. 774)

House Conference Report No. 101–222 August 4, 1989 (To accompany H.R. 1278)

Cong.Record Vol. 135 (1989)

The House bill was passed in lieu of the Senate bill. The House Report (Parts I, II, III, IV, V, VI, and VII) is set out below and the House Conference Report follows.

(CONSULT NOTE FOLLOWING TEXT FOR INFORMATION ABOUT OMITTED MATERIAL. EACH COMMITTEE REPORT IS A SEPARATE DOCUMENT ON WESTLAW.)

HOUSE REPORT NO. 101–54(I)

May 16, 1989, June 1, 8, 1989

The Committee on Banking, Finance and Urban Affairs, to whom was referred the bill (H.R. 1278) to reform, recapitalize, and consolidate the Federal deposit insurance system, to enhance the regulatory and enforcement powers of Federal financial institutions regulatory agencies, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

*87 FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

BACKGROUND AND NEED FOR LEGISLATION

The Committee on Banking, Finance and Urban Affairs, after vigorous investigation of the savings and loan industry and its insurance fund, extensive hearings, and the receipt of many additional views and recommendations, reported H.R. 1278, on May 2, 1989. The bill as reported makes significant changes in the Federal Deposit Insurance Act, the Federal Home Owners' Loan Act of 1933, the Federal Home Loan Bank Act, and the Bank Holding Company Act of 1956. The

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

National Housing Act is repealed in part and remaining sections have been incorporated into the Home Owners' Loan Act or the Federal Deposit Insurance Act. The Federal Home Loan Mortgage Corporation Act, the Bank Conservation Act, the Federal Credit Union Act, the Federal Financial Institutions Examination Council Act of 1978, and the Right to Financial Privacy Act of 1978 are also amended. Numerous other acts and statutes are amended to conform.

The bill as reported abolishes the Federal Savings and Loan Insurance Corporation and transfers the functions and activities of the Federal Savings and Loan Insurance Corporation and the Federal Home Loan Bank Board to the Federal Deposit Insurance Corporation or one of three newly created entities: The Office of Thrift Supervision, the Federal Housing Finance Board, or the Resolution Trust Corporation.

**2 This bill begins a new era for insured institutions and their regulators. However, to restore the strength of the thrift industry and the deposit insurance funds will require more than legislation. The Committee expects regulators to be vigilant and responsive, and most important of all, committed to the financial integrity of the insured institutions for which they are responsible.

INTRODUCTION

Throughout most of its history, the savings and loan industry was dedicated almost entirely to promoting home ownership through home mortgage lending, and as recently as last year, thrift institutions still originated 49% of all 1–4 family mortgages nationwide. However, the rising interest rate environment of the 1970's and early 1980's had a devastating affect on thrifts. Thrifts, locked into long-term, low-yielding, fixed-rate mortgages, experienced enormous operating losses. In response, the Congress and the Reagan Administration agreed to a rapid expansion in the scope of permissible thrift investment powers and a similar expansion in a thrift's ability to compete for funds with other financial services providers. This extensive deregulation, for which many thrifts were unprepared, coupled with a severe economic downturn in the*88 Southwest, left the industry struggling for survival, and has virtually wiped-out its deposit insurance fund, the Federal Savings and Loan Insurance Corporation (FSLIC). In the hope of salvaging the thrift industry, President Bush offered a plan that was introduced in the House of Representatives on February 22, 1989 as H.R. 1278, the Financial Institutions Reform, Recovery and Enforcement Act of 1989. This report provides an explanation of the Administration's plan as modified by the House Committee on Banking, Finance and Urban Affairs.

ESTABLISHMENT OF THE PRESENT FRAMEWORK: THRIFTS AND THE GREAT DEPRESSION

The savings and loan industry, or thrift industry as it is commonly known, got its start in the United States in the 1830's with the establishment of the Oxford Provident Building and Loan association in Frankfort, Pennsylvania. Throughout the remainder of the 1800's and early 1900's the thrift industry grew to establish a secure foothold within the domestic financial services industry. By the turn of the century there were over 5,300 thrift institutions operating in the U.S. with assets of approximately $570 million. These institutions had over 1,750,000 members and loaned money to over 450,000 individuals. Until the Depression, the thrift industry continued to prosper under the aegis of state chartering, regulation and supervision. By year-end 1928 there were 12,660 thrift institutions operating in the U.S. with assets of well over $8 billion.

The Great Depression spurred the reformation of the thrift industry into a federally-conceived and assisted system to provide citizens with affordable housing funds. It is accurate to say that the present thrift industry structure was born during the Depression.

**3 Due to massive unemployment, the Depression was particularly severe in its impact on housing; over 1,700 thrifts failed during the 1930's because borrowers could no longer service their mortgages. In total, thrift depositors lost roughly $200 million during the Depression. To address this crisis, in 1931, President Herbert Hoover appointed a "President's Conference on Home Building and Home Ownership" to study the need for a nationwide central credit facility to supply thrifts with needed mortgage funds. On December 4, 1931, the Conference endorsed just such a proposal, and on July 22,

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

1932, President Hoover signed into law the Federal Home Loan Bank Act despite strong opposition from banks and insurance companies complaining that the Act constituted excessive government intervention into the financial services industry. The primary purpose of the Act was to rescue the failing savings and loan industry by channeling cash to thrifts. The legislation authorized the creation of twelve district banks to lend money to thrifts, and established the Federal Home Loan Bank Board (Bank Board) located in Washington, D.C., to oversee the district banks. The Act also authorized the district banks to raise money by selling bonds. The Act created the Reconstruction Finance Corporation (RFC) to provide emergency funding to financial institutions. During its 15 years of activity, the RFC was able to provide over $100 million in assistance to thrift institutions.

*89 More help was needed,however. With 40 percent of the nation's $20 billion in home mortgages in default, and foreclosures taking place at a rate of 26,000 per month, Congress recognized the need for additional thrift legislation, and in 1933, the Home Owners' Loan Act (HOLA) was enacted. The HOLA authorized the Bank Board to grant Federal savings and loan association charters and created the Home Owner's Loan Corporation (HOLC) to purchase delinquent loans from lenders and refinance them at terms that allowed the home owner to avoid foreclosure. Over its life, the HOLC refinanced $2.75 billion worth of home mortgages, and invested $300 million in thrift institutions.

In a further attempt to restore public confidence in the nation's financial system, and to continue to assure an adequate supply of funding for home mortgages, the Congress passed the National Housing Act of 1934 (NHA). This Act established the Federal Housing Administration (FHA) and the Federal Savings and Loan Insurance Corporation (FSLIC). FHA insurance was intended to protect mortgage lenders by guaranteeing full repayment of defaulted loans covered by FHA programs. FSLIC insurance was intended to protect small depositors by insuring their time and demand deposits up to $5,000, thus encouraging the public to reinvest their funds in savings and loans.

THE POST–DEPRESSION YEARS

The post-Depression years saw the thrift industry develop into an important player in the financial services industry. In 1945 the savings and loan industry held 3 percent of the total financial assets in the United States; by 1985 thrifts held 15 percent. During this period the number of FSLIC-insured institutions and their branches increased dramatically while the amount of assets controlled by thrifts grew exponentially.

**4 The Depression and World War II produced a tremendous demand for housing. Although increased savings during the Second World War allowed savings and loans to establish a large deposit base, most of the funds on deposit at thrift institutions were not used to provide mortgages, but instead were used to purchase war bonds or to fund the construction of military housing. The Housing Act of 1949 recognized the national shortage of housing following the War and gave a boost to the thrift industry by making the provision of family housing a national priority.

From 1940–65, the number of FSLIC-insured thrifts more than doubled from 2,277 to 4,508. During that period the assets controlled by FSLIC-insured thrifts jumped from $3 billion to over $124.5 billion. Since 1965, the number of FSLIC-insured institutions has declined to 2,949, but the advent of branching offset this decline.

In 1940 most of the nation's thrifts were single office operations, but by 1960, nearly 3,000 institutions were engaged in branching. During this period the limitation prohibiting thrifts from providing mortgages on property outside a 50 mile radius of the institution's home office was extended to 100 miles. In 1970 thrifts were permitted to lend statewide and by 1983, nationwide except where prohibited. With effective and growing branch networks, deposits in the*90 thrift industry grew to $503 billion by 1980, with 96% of these deposits insured by the FSLIC. During this same period the assets of FSLIC-insured thrifts increased to over $621 billion.

MAJOR CAUSES OF THE THRIFT CRISIS

Promoting the availability of affordable housing has been a primary goal of the Federal government for many years. In an effort to further that goal, the Congress and many state legislatures created the specialized thrift industry to provide

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

people with mortgage credit. Every thrift is chartered by the government and consequently, voluntarily assumes an enormous public responsibility in return for deposit insurance and other government benefits. If thrifts are successful, they make a major contribution towards the achievement of the government's housing goals. If they fail, the government's goal of providing people with affordable housing suffers. Consequently, a critical factor in achieving the government's housing goal is the existence of a safe, efficient and viable thrift industry.

The thrift industry and FSLIC are now in perilous financial condition. The causes of this crisis can be traced to a number of factors: poorly timed deregulation; the dismal performance of some thrift managements; inadequate oversight, supervision and regulation by government regulatory agencies and the Reagan Administration; a regional economic collapse; radical deregulation by several large States; and outright fraud and insider abuse. What emerges all too clearly is that when the savings and loan industry was deregulated, the Reagan Administration, the Congress, several State legislatures, the government agencies assigned to supervise and examine these institutions, and the thrifts themselves badly misjudged the extent of the underlying problems.

A DECADE OF MODIFICATION: 1978–1988

**5 The regulatory framework designed by Congress in the 1930's to compartmentalize financial institutions began to experience severe stress during the late 1970's and early 1980's when periods of high interest rates and record levels of inflation rocked the nation's economy. Reacting to these pressures, the Congress and several state legislatures enacted numerous legislative initiatives aimed at securing the thrift industry's place as an important vehicle for promoting our nation's housing goals through the provision of affordable mortgage credit. These changes, summarily recounted in the following paragraphs, had a profound impact on the savings and loan industry.

In 1978, Congress passed the Financial Institutions Regulatory and Interest Rate Control Act (FIRICA) which provided for tighter controls on insider abuse, insider lending and interlocking directorates and enhanced the enforcement powers for financial institution regulators. The Act extended until 1980 the regulatory's authority to set maximum interest rates that savings and loans can pay on deposits at thrifts. The Act also authorized the Bank Board to charter Federal savings banks and increased FSLIC insurance coverage on both IRA and Keogh accounts from $40,000 to $100,000.

*91 The rising interest rate environment of the late 1970's and early 1980's produced conditions ripe for disintermediation, and resulted in large operating losses for most thrifts. In 1979 the Federal Reserve, in order to combat inflation, decided to pursue a different course in its conduct of monetary policy. That policy shift had a truly devastating affect on the thrift industry. With Paul Volcker at the controls, the Federal Reserve switched from a policy of stabilizing interest rates to a policy of controlling the growth of the money supply. This shift caused a dramatic increase in interest rates with an equally dramatic increase in the cost of funds at thrifts. At the same time, thrift assets were locked into long-term, low-yielding, fixed-rate mortgages. This meant thrifts were paying more to attract funds than they were earning on their mortgage portfolios. This "negative" interest rate mismatch was the beginning of the thrift crises as we know it.

PHASE–OUT OF REGULATION Q

As with previous crises in the financial services industry, Congress responded by passing major legislation. On March 31, 1980 President Carter signed into law the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMC). This Act phased out interest rate caps on bank and thrift deposits; raised federal deposit insurance coverage for all types of deposits from $40,000 to $100,000; authorized the Federal Reserve to set reserve requirements on short-term accounts at all depository institutions; and authorized depository institutions nationwide the opportunity to offer NOW (Negotiable Order of Withdrawal) accounts to enable them to compete for funding with money market mutual funds.

**6 The phase-out of Regulation Q culminated a decade long battle to eliminate deposit interest rate controls. Since the 1930's, Regulation Q had placed a ceiling on the rate of interest a financial institution could offer on deposits. As interest

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

rates and inflation gyrated dramatically during the 1970's and 1980's, nonbanking firms such as securities firms and insurance companies began offering money market mutual funds that paid market interest rates to customers. Customers gradually became more sophisticated and realized that as long as the inflation rate was higher than the interest rate they earned on their deposits, they were actually losing money by having major balances in depository institutions. In order to avoid losing money on their deposits, consumers periodically withdrew massive amounts of money from financial institutions, a phenomenon known as disintermediation.

Without loanable funds on hand at banks and savings and loans, the economy experienced credit shortages or "crunches" during periods of disintermediation. The mortgage credit-dependent construction industry experienced several severe downturns and home buyers in turn were harmed by shortages of mortgage funds. These factors persuaded the Congress to enact the Depository Institutions Deregulation and Monetary Control Act of 1980, and with it, the dismantling of deposit rate controls embodied in Regulation Q.

The savings and loan industry, which was subject to Regulation Q limitations starting in 1966, had relied heavily on Regulation Q as a means of attracting depositors. From 1966 until its dismantling,*92 Regulation Q gave thrifts the opportunity to pay savers higher rates than banks on time and savings deposits. This interest rate differential—25 to 50 basis points—provided thrifts with a powerful marketing tool. In repealing Regulation Q, Congress effectively repealed this advantage.

With Regulation Q being phased out, and deposit insurance coverage raised to $100,000, thrifts were able to compete in the marketplace for depositor funds. But competing for funds on even terms with other financial service providers meant paying higher interest rates to customers and dramatically increased the cost of funds for thrifts. Unfortunately, the earnings side of their balance sheets—their permissible investments—contained low-yield, fixed-rate, long-term mortgages. This meant thrifts were paying higher interest rates to attract depositors, but were precluded from making analogous adjustments in their mortgage portfolios. For example, in August 1981, 53% of thrifts' interest-bearing liabilities were in short-term certificates of deposit paying high market rates, while 85% of the industry's assets were in low-yielding, long-term, fixed rate mortgages.

By 1981 thrifts were paying an average of 11 percent for their funds while their mortgage portfolios were yielding only 10 percent—a negative 1 percent spread. As a result thrifts had a return on assets of negative 0.73 in 1981, and negative 0.65 in 1982. Even though thrifts were better able to compete for funding, disintermediation continued as net new deposits in thrifts declined by more than $25 billion in 1981. Thrifts had losses of $4.6 billion in 1981, and $4.3 billion in 1982. In 1981, 81 thrifts failed. In 1982, 252 failed and in 1983, another 102 failed.

**7 Double digit mortgage rates and inflation made people shy away from home purchases. Housing starts in 1981 and 1982 dropped to their lowest level in over 20 years. The thrift industry was in big trouble and looked to Congress, the Administration, and State legislatures to remedy their situation by expanding thrift powers and by asking for forbearance measures and net worth assistance to enable them to rebuild their net worth. These requests were granted by several states with a large number of thrifts, the Bank Board and Congress.

GARN–ST GERMAIN

The Garn–St Germain Depository Institutions Act of 1982, signed into law on October 15, 1982, was considered the most significant piece of thrift legislation since the Great Depression. The first section of the Act states that it is, "An Act to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans." To further stem the tide of disintermediation, Congress allowed thrifts to offer money market deposit accounts, with no interest rate limitations. This action was successful and helped reverse the outflow of funds from thrift institutions for the first time in two years; during the first four months that these accounts were offered, they attracted over $108 billion in deposits.

Garn–St Germain also authorized federally-insured thrifts to commit up to 10% of their assets to commercial or agri-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

cultural*93 loans; increased the non-real estate secured loan limit from 20% to 40% of assets; lifted educational loan restrictions making all educational loans permissible; authorized thrifts to invest 100% of their assets in state or municipal securities; permitted investments in time deposits and savings accounts of other thrifts; increased from 20% to 30% the permissible level of assets committed to consumer loans, including inventory and floor-planning loans; authorized thrifts to accept demand deposits from individuals and corporations; and allowed the use of net worth certificates to assist ailing FSLIC- and FDIC-insured institutions.

Altogether, these actions gave thrifts far greater flexibility in deciding how their money could be invested. As history showed, a number of thrift managers did not have the expertise needed to utilize these new powers, and as a whole the industry had great difficulty in exercising its newfound powers in a safe and sound manner. In addition, many states, bowing to the demands of their state-chartered thrifts, and not having to worry about the consequences of deregulation because deposit insurance was "federally-backed", drastically expanded the investment powers of state-chartered thrifts.

STATE–CHARTERED THRIFTS RESPONSIBLE FOR A MAJORITY OF FSLIC LOSSES

In 1980, 51 percent of FSLIC-insured S & L's were still state-chartered and received their powers from their state legislatures. Coinciding with federal efforts to aid ailing thrifts, numerous state legislatures, the most significant being California, Florida, and Texas, passed far reaching provisions to aid their ailing state-chartered institutions. By 1984, more than one third of all states had granted their state-chartered thrifts investment powers beyond those permissible for federally-chartered institutions.

**8 In addition to having greater powers, many state-chartered thrifts found a far less rigorous regulatory and supervisory environment at the state level. For example, the State of California let its thrift examination force drop dramatically during the early 1980's. The State of Texas followed the same pattern. Some of the most abusive and fraudulent activities affecting thrifts occurred in these states.

As long as the federal government was responsible for picking up the tab for a failed state-chartered thrift, there was no great incentive for many state legislatures to deny the sweeping demands for additional investment powers made by the thrift industry. The results were tragic. Seventy percent of all FSLIC expenditures during 1988 went to pay for problems created by high-risk, ill-supervised, state-chartered thrifts in California and Texas. Those same two states absorbed 54 percent of FSLIC expenditures in 1987.

RAP VS. GAAP ACCOUNTING

The difference between regulatory accounting principles (RAP) and generally accepted accounting principles (GAAP) played a central role in the thrift crisis. RAP accounting regulations, promulgated by the Bank Board and endorsed by Congress in the early*94 1980's, masked the true magnitude of the thrifts industry's woes and the level of insolvency of the FSLIC.

Common and preferred stockholder's equity, and other forms of capital like retained earnings, and certain types of subordinated debt, are the foundation of a safe and sound banking system. Capital protects a depository institutions from insolvency by providing a "cushion" to absorb losses in times of poor performance. Capital performs other useful functions such as enhancing the safety of depositor funds, helping maintain public confidence in the financial system, and supporting the expansion of banks and thrifts. A strong capital base is essential because the failure of a financial institution could lead to significant financial losses for depositors and the federal government. If capital levels are too low, managers may be willing to take excessive risks because of the perception that the FSLIC insurance fund will pay a substantial portion of the costs if the gamble fails.

A significant percentage of the thrift industry encountered large operating losses and capital depletion as a direct result of the interest rate spread problem of the early 1980's. In response, the Bank Board joined by thrift industry lobbying groups such as the U.S. League of Savings Institutions, persuaded Congress to provide legislative relief via capital assist-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ance to weak thrifts. The Bank Board itself provided regulatory relief by promulgating many regulatory accounting gimmicks that allowed thrifts to technically avoid insolvency, and thus to avoid being closed by the FSLIC.

Regulatory and statutory accounting gimmicks included permitting thrifts to defer losses from the sale of assets with below market yields; permitting the use of income capital certificates, authorized by Congress, in place of real capital; letting qualifying mutual capital certificates be included as RAP capital; allowing FSLIC members to exclude from liabilities in computing net worth, certain contra-asset accounts, including loans in process, unearned discounts, and deferred fees and credits; and permitting the inclusion of net worth certificates, qualifying subordinated debentures and appraised equity capital as RAP net worth. By 1984, the difference between RAP and GAAP net worth at S & L's stood at $9 billion. This meant that the industry's capital position, or stated differently, its cushion to absorb losses was overstated by $9 billion. Few policy makers clearly understood the implications of this problem. By 1986, the difference had grown to $13.3 billion. At year-end 1988, RAP capital stood at $61.1 billion while GAAP capital was $46.2 billion. In addition to RAP accounting, the Bank Board also reduced the permissible minimum net worth requirement for thrifts from 5% to 4% in 1980, and lowered it again to 3% in 1982. The use of various accounting gimmicks and reduced capital standards masked the worsening financial condition of the industry, and the FSLIC, and enabled many weak institutions to continue operating with an increasingly inadequate cushion to absorb future losses.

RAPID GROWTH IN THE INDUSTRY

****9** With little of their own capital at risk, the predominant feeling among many thrift managements was that the easiest way to***95** regain profitability and generate adequate levels of new capital, was to grow rapidly. Factors making this appear as a feasible course of action included rapidly dwindling levels of capital; insurance coverage up to $100,000 on deposits; pent-up mortgage demand from the severe recession; lax supervision; broad new investment powers; few interest rate controls; and the arrival of a robust national economic recovery.

Spurred in part by growing acceptance of broker-originated deposits, FSLIC-insured thrifts attracted net new deposits of $110 billion in 1983, and $111 billion in 1984. In 1984, FSLIC-insured liabilities increased $152.6 billion or 20%. From 1983 through 1986 total thrift liabilities grew a remarkable 65% from $674 billion to $1.1 trillion—with $824 billion insured by FSLIC. However, the Bank Board did not consider rapid growth a "problem" until 1985. In an attempt to reduce FSLIC's risk exposure to losses caused by the failure of rapid growth thrifts with poorly collateralized loan portfolios, the Bank Board adopted regulations linking net worth requirements to growth rates and required thrifts to obtain supervisory approval before directly investing more than 10 percent of their assets in potentially high-risk ventures such as real estate development, or subsidiary service corporations. In 1985 the House Banking Committee approved legislation to curtail thrift direct investment powers, but the legislation never reached the House Floor.

POOR MANAGEMENT AND FRAUD AT SAVINGS AND LOANS

The management of a thrift must decide what activities should be undertaken by the thrift, and how much risk should be taken to achieve its goals. These decisions involve consideration of the thrift's financial capacity, current market and customer base, technological developments, and evaluation of general economic and sectoral conditions to name a few ingredients essential for success. The more sophisticated, riskier and complicated decisions become, the easier it is for a wrong choice to affect the safety and soundness of the institution.

Poor thrift management decisions have resulted in failure for hundreds of FSLIC-insured thrifts, and consequently, the insolvency of the FSLIC. While the majority of thrifts are run by adequate and dedicated management, a minority of poorly operated thrifts have impaired the financial condition of the entire thrift industry. The losses were severely compounded by an enormous recession in the Southwest.

Failed institutions have a number of similar traits including inadequate board of director supervision; poor internal controls; poor underwriting and loan administration standards; and a reliance on brokered deposits or other highly volat-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ile sources of funds. These problems are the result of poor management.

The objectives of thrift internal controls are to (1) safeguard assets; (2) ensure the accuracy and reliability of data and compliance with policies, applicable laws and regulations; and (3) promote management efficiency. Failure to establish and maintain adequate internal controls is a breach of a manager's fiduciary duty to operate*96 a federally-insured thrift in a safe and sound manner. In a recent report, the GAO stated,

**10 We found that extensive and repeated violations of laws and regulations characterized the 26 failed thrifts we reviewed. Virtually every one of the thrifts was operating in an unsafe and unsound manner and was exposed to risks far beyond what was prudent.

The GAO also stated that these failed thrifts did not take corrective action and were unresponsive once internal control weaknesses were uncovered by regulators.

Inadequate supervision by boards of directors or the presence of one dominating individual on a board were present at most of the failed thrifts studied by the GAO. At one failed institution a dominant chairman of the board agreed to the acquisition of another thrift before receiving approval from the board. The transaction was never discussed with the other directors and within 2 years of the acquisition, examiners said fully 70 percent of the thrift's losses were due to the ill-conceived acquisition.

Many failed thrifts relied on volatile funding, such as brokered deposits controlled by a few individuals, which could be quickly withdrawn, paralyzing the institution. At one failed thrift, Jumbo Certificates of Deposit (usually deposits of $100,000 and over) made up 96 percent of total deposits. At another failed thrift, brokered deposits grew from 14% to 86% of all deposits in just one year. Because these funds are generally more expensive to obtain they cut into the interest margin earned on investments. Lower net interest margins encourage managers to take greater risks in order to maintain adequate earnings. Higher risks are all too often translated into higher failures.

Poor loan underwriting and administration standards have proved particularly detrimental to thrift institutions. Thrift regulators have reported weaknesses related to poor loan documentation and inadequate credit analysis at 92% of failed thrifts. Appraisal deficiencies go hand-in-hand with poor underwriting and administration standards. Federal regulations requiring thrifts to obtain appraisals for loans secured by real estate were violated by 88 percent of failed thrifts. In addition, many appraisals were found to be inaccurate or insufficiently documented.

INSIDER ABUSE AND FRAUD

While the majority of thrifts are run by honest and dedicated management, it is clear that fraud and insider abuse has been a major factor in a significant portion of thrift failures in the 1980's.

Many fraud cases involving FSLIC's largest losses have borne an uncanny resemblance. The general pattern has been a state chartered institution that underwent a change of control during the early 1980's. These institutions participated in rapid growth schemes and adopted risky investment strategies. Poor management techniques and unresponsiveness to regulatory appeals for change are also a hallmark of these institutions; so are high levels of compensation and extravagant expenditures. Regulators estimate that as many as 40% of thrift failures are due to some form of fraud or insider abuse.

**11 *97 The public accounting industry and certified public accountants (CPAs) played a major role in masking the insolvency of many failed thrifts, and often did not report fraud and insider abuse by thrift managements to thrift regulators. In a study of failed S & L's under the supervision of the Federal Home Loan Bank of Dallas, the GAO reported,

For six of the eleven failed S & L's we reviewed, CPA's did not adequately audit or report the S & L's financial condition or internal control problems in accordance with professional standards.

Independent audits are an integral part of the system of controls designed to identify and report problems in thrift's when they arise. A lack of professionalism and poor quality audit work by CPA's helped mask the presence of fraud at a number of failed thrifts. In many instances auditors did not notify regulators about poor management practices at failing

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

thrifts, which ultimately delayed regulatory action against many unscrupulous thrift managements. This delay has significantly raised the FSLIC's cost of resolving thrift failures.

INADEQUATE SUPERVISION OF THRIFTS

President Reagan promised the American people he would reduce government regulation because "it was hampering private initiative and impeding the functioning of the market." Throughout the Reagan years, the Treasury Department and the federal bank and thrift regulatory agencies continually pressured Congress to limit government intervention in the financial services industry. In line with this philosophy, the Administration would not support an increase in the number of savings and loan examiners even though the thrift industry was going through its most significant restructuring since the Great Depression. The lack of adequate supervision and examination of thrifts was one of the primary causes of the thrift crisis.

Because of the Administration's lack of support for tough regulation and supervision of high-flying and risk-laden thrifts, the FSLIC was unable to attract an adequate examination force at a critical time. Without adequate supervision, thrifts were free to engage in fraudulent and risky activities, often at the expense of the FSLIC.

Even when the Bank Board realized it needed more examiners, the Administration remained adamantly opposed to any increase in the examination force. In the mid–1980's, the Bank Board, pressured by Congress, finally realized it needed additional regulatory resources to deal with the FSLIC problem. The Bank Board appealed to the Office of Management and Budget (OMB) for additional resources, but was repeatedly ignored. Realizing it needed more examiners to deal with the problems of the thrift industry, the Bank Board finally transferred its examination function to its 12 regional federal home loan banks and out from under the limitations placed on it by the OMB and the Office of Personnel Management (OPM). This maneuver enabled the 12 regional banks to attract more examiners, but came too late; many institutions had ***98** already engaged in risky or fraudulent loan and investment activities which would lead to their ultimate failure.

CONFLICT OF INTEREST BETWEEN THE BANK BOARD AND THE FSLIC

****12** Several witnesses testifying at Banking Committee hearings stated that the relationship between the Bank Board, the FSLIC and the thrift industry was responsible for a major portion of the thrift crisis. The Bank Board chartered savings and loan institutions and perceived its role as that of industry promoter. Also, under the Bank Board's control was the FSLIC, charged with protecting the integrity of the thrift deposit insurance fund. Witnesses charged that the Bank Board's top priority clearly was to promote the thrift industry, often at the expense of its captive deposit insurance fund. Evidence offered to support this contention was the Bank Board's record of relaxing capital standards and a lack of enforcement actions against thrift operators.

A prime example of industry influence over the Bank Board is the Federal Asset Disposition Association or FADA. At the urging of several prominent thrift industry patrons in California, the Bank Board created FADA to manage and dispose of property taken over by FSLIC from failed thrifts.

The Bank Board created FADA with $25 million in Federal seed money without even notifying Congress that it intended to drastically alter the means in which the FSLIC was going to dispose of the assets of failed thrifts. The House Banking Committee discovered that FADA was rife with conflicts of interest and operating under very poor management. Backing up the House Banking Committee's findings, the GAO reported that FADA was losing money, and had not demonstrated it was any more efficient in disposing of property than was the FSLIC.

Even after the House Banking Committee passed bipartisan legislation calling for the winding down of FADA's operations, the Bank Board would not terminate FADA. A small group of industry proponents wanted FADA retained, and the Bank Board acquiesced even though FADA proved to be of little help to FSLIC and was a failure from the start.

SCOPE OF THE CURRENT PROBLEM

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The nation's thrift industry and its deposit insurance fund, the Federal Savings and Loan Insurance Corporation are currently in precarious financial condition and consumer confidence in the savings and loan industry is waning. A number of factors have contributed to the massive losses in the thrift industry, and the bankruptcy of FSLIC. The following sections illustrate the size of the FSLIC and thrift industry financial troubles, and explain the need for this legislation.

FINANCIAL CONDITION OF THE THRIFT INDUSTRY

During 1988 thrifts remained the nation's predominant mortgage lender, originating 49% of all residential mortgages in 1988 (up from 46% in 1987) for a dollar volume of $160.7 billion in mortgage loans. Thrifts remained a leading supplier to the secondary mortgage market, selling $271.8 billion in mortgage loans during 1988.

*99 As of December 31, 1988, there were a total of 2,949 FSLIC-insured savings and loans operating nationwide, holding deposits of $971 billion and assets of $1.35 trillion. In total, these institutions lost $12.1 billion in 1988.

**13 Statistics reveal that the present thrift industry crisis is far from systemic (see table below). At the end of 1988, 70 percent of all thrifts were profitable. These thrifts earned over $3.7 billion in 1988 and control well over 70 percent of the industry's assets. There are now approximately 1,225 thrifts with over 6 percent capital based on Generally Accepted Accounting Principles (GAAP). Eighty-one percent of this group was profitable in 1988 earning a combined $2 billion. As a group they had an average GAAP capital-to-assets ratio of nearly 9 percent at year-end 1988, and a respectable average return on assets for the year of .72 percent.

Type of thrift	Number of thrifts (Dec. 31, 1988)	Total assets (billion dollars)	1988 net income (billion dollars)	Percent profitable
Healthy thrifts (GAAP capital greater than 3 percent)	2,195	923.2	3.7	81
GAAP-insolvent thrifts (GAAP capital less than 0)	364	113.5	(14.8)	12
Troubled thrifts (GAAP capital 0–3 percent)	390	314.8	(1.0)	56
Total FSLIC-insured thrifts	2,949	1,351.5	(12.1)	70

As the table indicates, the healthy savings and loans are more representative of the industry as a whole, but unhealthy thrifts have bankrupted the FSLIC and jeopardized the future of the industry.

The present thrift crisis is concentrated in the roughly twenty-five percent of the industry having GAAP capital of less than 3%. At year-end 1988, 754 thrifts fell into this category. Only 35% of these "troubled" institutions managed a profit in 1988. As a group they posted a loss $15.8 billion in 1988, and at year-end they controlled assets of $428.3 billion.

Three hundred sixty-four of the troubled thrifts had a GAAP capital-to-assets ratio of less than zero, and 88% of these institutions slipped further into insolvency during 1988. Together, these 364 insolvent thrifts lost $14.8 billion in 1988, and ended the year with assets of $113.5 billion and net worth of negative $11.6 billion.

Most troubling are the 390 "marginal" thrifts with GAAP capital of between zero and 3 percent. In total, these institutions, with assets of $314.5 billion, lost $1.0 billion in 1988; only 56% were able to post a profit. In other words, 46% of these thinly capitalized thrifts slipped further towards insolvency. In addition, many experts fear that the value of their

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

assets is significantly overstated.

Given that the majority of troubled thrifts were not profitable in 1988, and that the $428.5 billion in assets that they control may be significantly overstated, the Administration's Plan to provide $50 billion to deal with insolvent thrift's over the next three years may be insufficient.

REGIONAL CONCENTRATION

A majority of distressed thrifts are concentrated in the Southwest and California. For example, thrifts under the supervision of the Federal Home Loan Bank of Dallas lost $1.6 billion in the*100 fourth quarter of 1988, and they registered GAAP capital of negative $4.4 billion at the close of 1988; Dallas is the only region to post negative GAAP capital. At year-end 1988, 135 of the 399 FSLIC-insured thrifts in the Dallas Region were insolvent. These thrifts control $40 billion in assets and lost $1.5 billion in the fourth quarter of 1988 alone. Thrifts under the supervision of the Federal Home Loan Bank of San Francisco lost $200 million in the fourth quarter, while thrifts under the jurisdiction of the Federal Home Loan Bank of Des Moines lost $340 million in the fourth quarter. In addition, thrifts in the States of Colorado and Louisiana are experiencing severe difficulties.

**14 Regions posting a profit in the fourth quarter of 1988 included New York, Boston, Cincinnati, Indianapolis and Chicago. Together thrifts in these regions earned a combined $193 million during the fourth quarter 1988.

FSLIC FINANCIAL CONDITION RAPIDLY DETERIORATING

The deteriorating condition of the thrift industry has overwhelmed the resources of the FSLIC. During 1988, the FSLIC acted on 223 problem thrifts including 179 assisted mergers and acquisitions, 26 liquidations, and 18 consolidations. On a cash basis these deals will ultimately cost the FSLIC at least $60–70 billion. Testifying before the Banking Committee, the General Accounting Office stated that at year-end 1988 the FSLIC was insolvent by over $50 billion, almost quadrupling the $14 billion dollar amount of insolvency at year-end 1987. During 1987 the FSLIC lost $8.5 billion, and the GAO estimates its loss for 1988 to be over $40 billion. At year-end 1988 there were 364 insolvent thrifts still operating. Estimates place the cash basis cost of dealing with these institutions at over $40 billion. Insolvency is not the only indicator of future problems for FSLIC. At year-end 1988 there were 390 thrifts, with assets of $314.8 billion, operating with a GAAP-capital level of between 0 and 3 percent. Just over half of these 390 thrifts were profitable during 1988, and as a group they lost over $1 billion in 1988.

According to the GAO, the FSLIC was in a combined deficit position of at least $56 billion on December 31, 1988. Moreover, the FSLIC reported a liability of over $37 billion incurred from action on the 223 problem thrifts it dealt with in 1988 alone. It is important to note that $37.1 billion represents FSLIC's estimated present value of liabilities. The actual cash outlays over the next 10 years may be well in excess of $62 billion.

EMERGENCY NATURE OF THE PROBLEM

On February 6, 1989, eighteen days after his Inauguration, President Bush announced a comprehensive plan to resolve the crisis in the savings and loan industry. At a press conference announcing the plan, the President stated, "I have decided to attack this problem head-on, with every available resource of our government because it is a national problem. I have directed that the combined resources of the federal agencies be brought together in a team effort to resolve the problem." At the same press conference, Secretary of Treasury Nicholas Brady mirrored the President's concern over the thrift crisis, stating, "From the day five months ago that I *101 was sworn in as Secretary of Treasury, achieving a sound and responsible resolution of the savings and loan crisis has been a top priority." Congressman Henry B. Gonzalez, Chairman of the Committee on Banking, Finance and Urban Affairs, stated that resolving the FSLIC crisis was the Banking Committee's top priority in the 101st Congress. Senator Donald W. Riegle, Jr., of Michigan, echoed Chairman

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Gonzalez's remarks upon being elected Chairman of the Senate Committee on Banking, Housing and Urban Affairs.

CONSUMER CONFIDENCE DIMINISHING

**15 Consumer confidence in the nation's savings and loan system has been declining rapidly over the last several months; consumer fears about the stability of the system have resulted in record withdrawals. During the first quarter of 1989, S & L's experienced withdrawals totaling $28.5 billion, breaking the previous annual record of $25 billion withdrawn in 1981.

Low depositor confidence in savings and loans as evidenced by record deposit outflows, the need to combat fraud and insider abuse, coupled with the severe insolvency of FSLIC, make the immediate resolution of the crisis imperative. Based on the emergency nature of the problem, the Committee has expedited its consideration of the Bush Administration's plan for resolving the crisis.

UNDERSTATEMENT OF THE MAGNITUDE OF THE PROBLEM

The Bank Board and the Reagan Administration continually understated the magnitude of the S & L crisis, effectively delaying its resolution and needlessly adding billions of dollars to the cost of resolving the problem.

Past and present Bank Board Chairmen have criticized those making more accurate estimates of the magnitude of the problem. Edwin J. Gray—who towards the latter part of his tenure as Chairman of the Bank Board supported a $15 billion recapitalization of the FSLIC—in a January 27, 1986 letter chastised GAO for estimating the size of the FSLIC insolvency at $6 billion. Mr. Gray stated, "while the raw data base (the Bank Board's) for this report is accurate, its utilization distorts the magnitude of the problem facing the FSLIC. I trust you share my concern that the magnitude of the problem facing the FSLIC not be, perhaps inadvertently, overstated. Such an overstatement could only serve to worsen the actual (FSLIC) situation." By the time Mr. Gray left his position as Chairman, the Bank Board estimate of resolving terminally-ill thrift cases reached $23.5 billion. But this estimate was reduced by Mr. Gray's replacement, M. Danny Wall.

Under M. Danny Wall, the Federal Home Loan Bank Board continually underestimated the financial difficulty facing the FSLIC and the thrift industry. One of the major factors undermining this Committee's confidence in the Bank Board has been Mr. Wall's dismal record of measuring the magnitude of the FSLIC problem.

A summary of Chairman Wall's estimates of the magnitude of the crisis before Congress are as follows:

February 4, 1988—Mr. Wall appeared before the House Banking Committee's General Oversight Subcommittee and assured*102 Members that the range of magnitude of the FSLIC "hole" on a worst-case basis was $15 to $16 billion.

May 26, 1988—At a Senate Banking Committee oversight hearing on the condition of the financial services industry, Mr. Wall estimated resources at the disposal of FSLIC over 10 years would be $30.2 billion; and that the estimated costs of resolving the FSLIC crisis would be $22.7 billion. Chairman Wall said the FSLIC has sufficient resources "in the near term" to deal with the problem.

**16 July 7, 1988—In a House Banking Committee hearing on the condition of the federal deposit insurance funds, Mr. Wall testified that there would be $42.5 billion in resources available to FSLIC over 10 years. Later that day he called a news conference to clarify that the size of the problem was not $42.5 billion.

September 8, 1988—During a House Banking Committee hearing on Full Faith and Credit for FSLIC notes, Mr. Wall revealed no estimate, but promised the Committee an updated estimate of the Texas problem within 30 to 45 days. Chairman Wall did not believe the Texas problem would be in the $25 to $40 billion range as Committee Members suggested.

October 5, 1988—During a Senate Budget Committee hearing on FSLIC, Chairman Wall introduced a $45 to $50 billion cost estimate of resolving sick thrifts. Mr. Wall also stated that a market recovery appeared to be under way in several regions, even within Texas. Mr. Wall also stated that he expected "the pace of case resolutions will slow considerably" following the expiration of certain favorable tax code provisions at the end of 1988.

January 10, 1989—When asked by Chairman Gonzalez at a House Banking Committee hearing on the S & L crisis if

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

FSLIC would have sufficient cash flow over the next 10 years to meet the recurring interest payments and to retire the notes issued in 1988, Chairman Wall responded "Yes". When Chairman Gonzalez pressed the point, Wall attempted to qualify his remarks.

Asked by Chairman Gonzalez if FSLIC had the resources to solve the thrift crisis on its own and why he had modified his earlier positions regarding this question, Mr. Wall referred to testimony by his fellow Bank Board Member, Mr. Roger Martin. That testimony addressed the rising cost of funds, but failed to give a firm estimate of the cost to resolve the problem. Mr. Martin did note that it would have been significantly more expensive for FSLIC to liquidate those institutions involved in the December, 1988, assisted transactions than to resolve them over a 10 year period as FSLIC chose to do. Martin said the Bank Board had little choice other than to merge the thrifts given that it did not have the $47 billion cash on hand needed to liquidate these institutions.

January 26, 1989—At a House Budget Committee hearing on the thrift crisis, Mr. Wall told the Committee the Bank Board would have a revised estimate on the cost of the FSLIC crisis by the end of the month.

*103 February 22, 1989—During a House Ways & Means Committee hearing on the budget impact and tax considerations of a S & L bailout, Mr. Wall presented an estimate of $75 to $80 billion, and stated that the $90 billion that would be made available by the Bush Administration's plan to address the problems of insolvent thrift institutions was consistent with the amount that the FSLIC and outside observers estimated was needed. Mr. Wall said the $75–80 billion estimate only includes FSLIC activities already entered into and "is not a projection of the cost of resolving all future problems in the S & L industry."

**17 March 1, 1989—During a Senate Banking Committee hearing on President Bush's FSLIC Plan, Mr. Wall's testimony included the February estimate of $75 to $80 billion to resolve the crisis. Mr. Wall testified that the $90 billion provided for in the President's plan was in line with Bank Board estimates of the funds needed to cover FSLIC's liabilities.

The Bank Board has never provided the House Banking Committee with an accurate estimate of the cost of resolving the thrift crisis. The Treasury, which said it relied on the Bank Board's numbers, also repeatedly underestimated the size of the FSLIC problem. By constantly understating the magnitude of the FSLIC problem, the Bank Board and the Treasury Department assuredly delayed Congressional action on a FSLIC rescue package.

NEED FOR THE LEGISLATION

The need for this legislation is clear. The Administration and the Congress must restore public confidence in the savings and loan industry in order to ensure a safe, stable, and viable system of affordable housing finance. Over the past several years the Committee has heard from hundreds of witnesses testifying on various aspects of the thrift crisis. These witnesses, and other experts, have pointed out the major flaws in our thrift system. The President's Plan, strengthened by modifications made by the House Banking Committee, attempts to rectify the flaws in the present structure and regulation of the thrift industry in order to ensure the problem is never repeated.

PURPOSE OF THE LEGISLATION

The primary purposes of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 are to provide affordable housing mortgage finance and housing opportunities for low- and moderate-income individuals through enhanced management of federal housing credit programs and resources; establish organizations and procedures to obtain and administer the necessary funding to resolve failed thrift cases and to dispose of the assets of these institutions; establish a distinction between the regulatory and insurance functions of the thrift industry by (1) ensuring a well capitalized and independent thrift insurance fund, (2) enhancing thrift industry regulation by providing for stronger supervisory oversight of the industry under the Department of Treasury; establish stronger capital standards for thrifts; and, enhance the regulatory enforcement*104 powers of the depository institution regulatory agencies to protect against fraud, waste

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

and insider abuse.

SUMMARY OF MAJOR PROVISIONS

I. Managing the crisis

The interests of the American taxpayer demand an expedited resolution to the monumental problems involved with the unprecedented costs of dealing with hundreds of insolvent thrifts and the orderly disposition of the assets of these failed institutions.

(a) Financing

To fund the resolution of the crisis, the legislation creates an off-budget, government sponsored entity, called the Resolution Funding Corporation (REFCORP). REFCORP will issue $50 billion in securities—interest on these obligations will be paid out of the proceeds from resolving failed thrifts, from Bank Board contributions, and from Treasury appropriations. The principal on these obligations will be paid out of the proceeds of zero-coupon bonds purchased with contributions from the 12 federal home loan banks, from deposit insurance premiums, and receivership proceeds. The $50 billion will be used to resolve those thrifts that became insolvent after January 1, 1989 or those that will become insolvent within three years from the date of enactment of the legislation. In addition, the Administration's plan provides up to $33 billion to recapitalize the savings and loan insurance fund between 1991 and 1999.

**18 The Banking Committee is relying on the Administration's $50 billion estimate of the total cost of resolving the FSLIC crisis, but this estimate may be seriously understated. Four major factors support this contention. They include (1) the unknown financial condition of 754 insolvent or thinly capitalized thrifts which control $428.5 billion in assets; (2) the belief by many experts that the assets of insolvent and thinly capitalized thrifts may be significantly overstated; (3) the Bank Board's and Treasury's poor record of estimating the size of the FSLIC crisis; and (4) the Administration's use of optimistic economic assumptions in arriving at its cost estimate. Taken together, all these factors compel the Committee to express serious reservations concerning the Administration's estimate of the total cost of resolving the thrift crisis.

(b) Asset disposition

The legislation establishes a Resolution Trust Corporation (RTC) to manage and dispose of the assets acquired from failed thrifts. The RTC will be a wholly-owned government corporation directed by a five member board including the Secretary of the Treasury who shall serve as the Chairperson, the Chairman of the Board of Governors of the Federal Reserve, the Attorney General of the United States, the Secretary of Housing and Urban Development and a real estate or finance expert from the private sector. The legislation includes provisions for Congressional oversight of the RTC and provides measures to prevent dumping of thrift asset at deeply discounted prices. While the RTC is established as a separate entity, the legislation provides that the FDIC will act for the RTC*105 until such time as the RTC is able to perform its duties and allows the RTC to contract with the FDIC after that time.

II. Public purposes

The savings and loan industry, and its extensive Government-backed support mechanisms, were enacted to provide Americans with an affordable source of mortgage credit. It is reasonable to expect the savings and loan industry to rededicate itself to the purpose for which the industry was originally created—providing affordable home mortgages. The Committee agrees with the Administration that the availability of home mortgages and the viability of the thrift industry are interrelated. The Committee took the necessary steps to ensure that affordable home mortgages will be made available to all individuals, including low- and moderate-income individuals.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

(a) A healthy thrift industry

An efficiently functioning thrift industry is one of the cornerstones of America's housing industry. The majority of home mortgage loans are originated by thrifts and their affiliates and, while insolvent thrifts attract attention, most of our nation's savings and loan industry, particularly those institutions which serve their communities through the home loan market, remain profitable. A major tenet of this legislation is a commitment to maintain a separate and viable industry charged with promoting home ownership through the provision of affordable mortgage credit. This commitment includes the maintenance of a separate deposit insurance fund for thrifts and the assurance that deposits in thrifts up to $100,000 are backed by the full faith and credit of the Federal government.

(b) Housing opportunities

**19 The thrift industry was created to provide the American people with affordable mortgage credit. Accordingly, the Committee adopted several housing-related initiatives that are compatible with the spirit and intent of the legislation.

The Federal Home Loan Bank System was originally designed to link member thrifts to the capital markets by providing them with advances for the purpose of granting mortgage loans. The Committee established additional mechanisms within the separate home loan district banks to target some of their earnings for low- and moderate-income housing and community development programs.

The legislation requires each home loan district bank to establish credit advance windows to provide funding below or at the bank's marginal cost of funds for specific projects serving low- and moderate-income residents.

The Committee also directed the regulatory agencies and the RTC to foster home ownership opportunities for low- and moderate-income individuals in those cases where it is prudent and reasonable to expect that suitable repossessed homes will not be readily sold at market prices. The intent of the Committee is to utilize unused housing to foster home ownership in areas where these units would otherwise remain vacant.

*106 III. Safeguards for the future

"Never Again", the theme of the Committee's deliberations, is reflected in numerous provisions of the bill which provide for the early detection of problems in financial institutions and the prevention of losses to the deposit insurance funds and the U.S. Treasury.

(a) Effective regulation

The Committee recognizes that many of the problems facing the FSLIC and the thrift industry stem from the concentration of responsibility and authority within the Federal Home Loan Bank Board and the potential for conflicts of interest which may arise because of close ties between the Bank Board and the thrift industry.

The legislation transfers regulatory and chartering functions of the Bank Board to a newly created Office of Thrift Supervision (OTS), under the administration of the Department of Treasury. The insurance function of the FSLIC will be transferred to the FDIC which will now administer both the commercial bank and thrift deposit insurance funds.

Both insurance funds will be maintained as separate entities; there will be no commingling of the funds. Responsibility for liquidation and disposition of assets of failed institutions will be transferred to the FSLIC Resolution Fund which will be managed by the FDIC, or to the RTC for conservators and receivers appointed after January 1, 1989.

Finally, the credit function of the Federal home loan banks will remain within the twelve Federal home loan district banks. These banks will be supervised by a separate Federal Housing Finance Board independent of the Treasury.

(b) Independent insurance funds

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

It is the objective of the Congress and the Administration to maintain separate federal deposit insurance funds. Both the commercial bank and thrift deposit insurance funds will be under the control of the FDIC. The legislation renames the two insurance funds; the Bank Insurance Fund (BIF), serving commercial banks, and the Savings Association Insurance Fund (SAIF), for the thrift institutions. Member institutions will be required to pay increased premiums until each fund has sufficient resources to cover potential liabilities to the fund.

(c) Stronger capital requirements

**20 A depository institution's capital, such as common and preferred stockholder's equity, retained earnings, provide a cushion against losses incurred in times of poor financial performance. To a considerable extent, the size of the thrift crisis resulted from the utilization of capital gimmicks that masked the inadequate capitalization of thrifts. It is the shared belief of the Committee and the Administration that if a crisis of this nature is to be prevented from happening again, thrifts must be adequately capitalized against losses.

The legislation seeks to provide this protection by establishing a core capital requirement of 3% of assets for savings institutions. *107 The 3% core capital standard takes effect on June 1, 1990. Beginning then, certain qualifying intangibles can be included on a declining basis until, by January 1, 1995, the 3% must be met without any qualifying intangibles.

In addition, within 180 days of enactment of the bill, regulations will be prescribed for risk-weighted capital standards which will be materially equivalent to and no less stringent than the risk-based capital standards applied to national banks.

(d) Enhanced enforcement powers

The Committee adopted provisions which expand, enhance and clarify enforcement powers of the financial institution regulatory agencies. The legislation increases civil and criminal penalties for crimes involving financial institutions and improves methods to detect misconduct in financial dealings.

The Department of Justice is directed to establish new regional offices within its Criminal Division to enhance its ability to prosecute incidents of misconduct involving financial institutions. The Justice Department is authorized to spend an additional seventy-five million dollars for the purpose of pursuing the prosecution of individuals who have acted illegally against financial institutions. It is the intent of the Committee that this action will give a clear signal to those who would violate federal banking laws that such conduct will not be tolerated.

(e) Certified and licensed appraisers

Extensive Congressional hearings, GAO reports and regulatory agency studies have documented the pervasive use of faulty and fraudulent real estate appraisals by unscrupulous thrift managements. Thrift regulations require a lender to get property appraised before being permitted to grant a loan on ceratin real estate projects. An appraisal is supposed to protect thrifts against losses by ensuring that collateral backing the loan is properly valued. Faulty appraisals make unsafe and unsound real estate loans appear adequately collateralized. Collusion between thrift managers, real estate appraisers and borrowers has cost the FSLIC billions of dollars.

In order to thwart real estate appraisal abuses, the legislation establishes a system of uniform national real estate appraisal standards. It also requires the use of state certified or licensed appraisers for real estate related transactions with the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the RTC, or certain real estate transaction regulated by the federal financial institution regulatory agencies.

(f) Audits and studies

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**21 A comprehensive review of the present condition of the insurance funds and a detailed study of changes that may affect the funds may identify additional safeguards against future threats to the funds. The legislation directs the Treasury to conduct a complete study of the federal deposit insurance system and to make recommendations concerning a host of financial conditions which may affect the funds in the future. The FDIC is required to do an*108 annual review of the condition of the federal deposit insurance funds. In addition, the GAO is required to review federal deposit insurance issues.

To ensure that any increased costs of banking operations be fairly allocated between all consumers, the Federal Reserve is charged with the task of conducting an annual survey of retail banking services and the fees imposed for these services. A Credit Standards Advisory Committee is established to review credit standards and lending practices and make recommendations on appropriate loan standards.

The legislation requires each federally-insured financial institution to have an annual audit conducted by an independent public accountant. For institutions with under $150 million in assets, alternative, less costly audit standards will be provided by the regulatory agencies. In addition, each insured institution will be required to report to the supervisory agencies on compliance with safety and soundness rules such as the adequacy of internal controls, and on the institutions compliance with applicable laws and regulations.

HISTORY OF THE LEGISLATION

On August 10, 1987, President Reagan signed into law the Competitive Equality Banking Act of 1987 (P.L. 100–86), commonly known as CEBA. Title III of CEBA, entitled the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987, provided $10.8 billion to recapitalize the ailing Federal Savings and Loan Insurance Corporation (FSLIC). Title IV of CEBA, entitled the Thrift Industry Recovery Act of 1987, provided the Federal Home Loan Bank Board with an approach for dealing with troubled but well-managed and viable thrifts in those areas of the country which have weakened economies due to slumps in energy, agriculture and real estate markets. Taken together, the overall objective of these two titles was to provide funding to stabilize the FSLIC, and to insure the long-term viability of the thrift industry at the lowest cost to the FSLIC.

The House Banking Committee held exhaustive hearings designed to examine the problems and prospects of the savings and loan industry and its beleaguered federal deposit insurance fund, the Federal Savings and Loan Insurance Corporation. On January 21, 1987 the Committee heard from Patrick A. Forte, President, Association of Thrift Holding Companies; Gerald J. Levy, Immediate Past Chairman, U.S. League of Savings Institutions, accompanied by W.W. McAllister; David J. Sullivan, Jr., President and Chief Executive Officer, Mechanics and Farmers Savings Bank, Bridgeport, CT.

**22 On January 22, 1987, the Committee heard from the Honorable George D. Gould, Under Secretary for Finance, Department of the Treasury; and Edwin J. Gray, Chairman, Federal Home Loan Bank Board.

On March 3, 1987, the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance, held hearings and the witnesses were: L. Linton Bowman, III, Commissioner, Texas Savings and Loan Department, State of Texas; Jon Corzine, Senior Partner, *109 Goldman, Sachs & Co., NewYork, NY; Roy G. Green, President, Federal Home Loan Bank of Dallas, Dallas/Ft. Worth, TX; Walter McAllister, III, President, Texas Savings and Loan League and Chairman, Forbearance Committee, U.S. League of Savings Institutions; Lionel J. Nowotny, President, Watson & Taylor, Realty Co., Dallas, TX; Roslyn Payne, President and CEO, Federal Asset Disposition Association, San Francisco, CA; David N. Peterson, President, Society of Real Estate Appraisers, Phoenix, AZ; accompanied by Dr. William N. Kinnard, Jr., President, Real Estate Counseling Group of Connecticut, Storrs, CT; H. Joe Selby, Executive Vice President and Director, Regulatory Affairs, Federal Home Loan Bank of Dallas, Dallas/Ft. Worth, TX; Frederick D. Wolf, Director, Accounting and Financial Management Division, U.S. General Accounting Office.

On March 4, 1987, the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance received testi-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

mony from W. Drew Darby, Attorney, West Texas Lenders; accompanied by Thomas J. Sullivan, Jr., Chairman of the Board, Tristar Capital Corp., Dallas, TX; Jim Fogleman, Chairman and CEO, Louisiana Savings Association, Lake Charles, LA; Jenard M. Gross, Chairman and Chief Executive Officer, United Savings Association of Texas, Houston, TX; Don Guidry, President, Lafayette Building Association, Lafayette, LA; Scott Hudson, former owner of Savings and Loan Associations and Commercial Banks and former Prosecutor, Dallas, TX; Wade T. Nowlin, Chairman and Chief Executive Officer, Nowlin Savings and Nowlin Mortgage Co., Ft. Worth TX; accompanied by H. Robert Frenzel; Donald F. Roby, President and Chief Executive Officer, Farm and Home Savings Association, Nevada, MO; Nolan L. Rumbley, Executive Vice President, American Federal Savings, Des Moines, IA; Thomas J. Sullivan, Chairman of the Board, Tristar Capital Corporation, Dallas, TX; James R. Turner, President, Kansas League of Savings Institutions, Topeka, KS.

On May 14, 1987, the Subcommittee on General Oversight and Investigations held a hearing regarding the findings of Booz, Allen & Hamilton which did a study on ways in which the Bank Board could better utilize its resources to deal the FSLIC cases. Witnesses testifying at the hearings were: Edwin J. Gray, Chairman, Federal Home Loan Bank Board, accompanied by Shannon Fairbanks, Chief of Staff, Bank Board.

On June 11, 1987, the Subcommittee on General Oversight and Investigations held a hearing related to the extinguishment of the FSLIC's secondary reserve fund and its subsequent impact upon the nation's FSLIC-insured institutions. The witnesses for this hearing were: Charles John Koch, First Vice Chairman, National Council of Savings Institutions; James J. Leisenring, Director of Research and Technical Activities, Financial Accounting Standards Board; Joe C. Morris, Chairman, U.S. League of Savings Institutions; Gregory J. Pulles, Chairman, Law Committee, Association of Thrift Holding Companies; Frederick D. Wolf, Director, Accounting and Financial Management Division, U.S. General Accounting Office.

**23 On June 17, 1987, the Subcommittee on General Oversight and Investigations continued its hearings on the extinguishment of the *110 FSLIC's secondary reserve fund. Witnesses were Edwin J. Gray, Chairman, Federal Home Loan Bank Board; Douglas J. McEachern, Chairman, Savings and Loan Associations Committee, American Institute of Certified Public Accountants.

On August 10, 1987, the Subcommittee on General Oversight and Investigations held a field hearing in Santa Ana, California regarding capital adequacy in the savings and loan industry. The witnesses were: Michael H. Allen, Member, Board of Directors, National Council of Savings Institutions; First Savings and Loan Association of Beverly Hills, CA; Honorable Jim Bunning, a Representative in Congress from the State of Kentucky; Richard, Terzian, Senior Vice President and Treasurer, Great Western Financial Corporation, Beverly Hills, CA; Lawrence Trautman, Senior Vice President, Donaldson, Lufkin & Jenrette, New York, NY.

The last hearing in the First Session of the 100th Congress on the savings and loan industry's troubles was held on October 15, 1987, by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance. The hearing topic was the Federal Asset Disposition Association. During this hearing the Subcommittee heard testimony from the Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board.

The House Banking Committee resumed comprehensive hearings on the status of the Federal Savings and Loan Insurance Corporation soon after the second session of the 100th Congress commenced.

On February 4, 1988, the Subcommittee on General Oversight and Investigations held a hearing on the progress of the recapitalization of the FSLIC. The witness was the Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board.

On July 7, 1988, the House Banking Committee held hearings on the financial condition of the Federal Deposit Insurance Funds. The witnesses representing the Bank Board were the Honorable M. Danny Wall, Chairman, accompanied by Roger F. Martin and Lawrence J. White, Members, Federal Home Loan Bank Board.

On August 2, 1988, the Subcommittee on General Oversight and Investigations held hearings related to legislation to establish a national thrift institutions commission. The witnesses were: H. Robert Bartell, Jr., Second Vice Chairman, National Council of Savings Institutions; Robert H. Dugger, Chief Economist, American Bankers Association; J.R.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Nunn, President Independent Bankers Association of America; Hon. Stanford E. Parris, a Representative in Congress from the 8th District of Virginia; Theo H. Pitt, Jr., Chairman, U.S. League of Savings Institutions.

On August 3, 1988, the Banking Committee heard from L. William Seidman, Chairman, Federal Deposit Insurance Corporation regarding the financial condition of the deposit insurance funds.

On September 8, 1988, the Banking Committee held hearings on placing the full faith and credit of the U.S. Government behind FSLIC notes. Testifying were: The Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board; and George D. Gould, Under Secretary for Finance, Department of the Treasury.

**24 On September 15, 1988, the Banking Committee, continued hearings on placing the full faith and credit of the U.S. government behind FSLIC notes. The witnesses were: Frederick D. Wolf, Director,*111 Accounting and Financial Management Division, U.S. General Accounting Office; Bert Ely, President, Ely & Company, Inc.; Walter P. Schuetze, Chairman, Accounting Standards Executive Committee, accompanied by Douglas J. McEachern, Chairman, Committee on Savings and Loans for the American Institute of Certified Public Accountants.

On January 10, 1989, the Banking Committee held hearings on FSLIC assistance programs. The witnesses were: The Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board, accompanied by Lawrence J. White, Board Member, Federal Home Loan Bank Board; Roger Martin, Board Member, Federal Home Loan Bank Board; George Barclay, President, Federal Home Loan Bank Board of Dallas; and Jordan Luke, General Counsel, Federal Home Loan Bank Board.

On January 12, 1989, the Banking Committee held field hearings in San Francisco on the examination and supervision of depository Institutions. The Committee received testimony from James Cirona, President and Principal Supervisory Agent, San Francisco Home Loan Bank; accompanied by Mike Patriarca, Director of Regulatory Activities; and William Black, General Counsel; William Crawford, Commissioner, California State Department of Savings and Loans; accompanied by William Davis, Deputy Assistant Commissioner; Robert T. Parry, President, Federal Reserve Bank of San Francisco; Anthony S. Scalzi, Director, San Francisco Regional Office, Federal Deposit Insurance Corporation; William Stolte, Director, San Francisco Regional Office, Comptroller of the Currency; Howard Gould, Superintendent of Banks, State of California; Patrick Johnston, Chairman, Committee on Finance and Insurance, California Assembly; Herb Sandler, Chairman of the Board of Directors, World Savings, Oakland, California; Gerald Barten, Chairman and Chief Executive Officer, Oaktree Savings Bank, California; Richard M. Rosenberg, Vice–Chairman of the Board, Bank of America; Carrol Pruett, President, Mid–State Bank, Arroyo Grande, California.

On January 13, 1989, the Banking Committee held field hearings in San Francisco on the examination and supervision of depository institutions. The witnesses were: Edwin J. Gray, Former Chairman, Federal Home Loan Bank Board; Frederick D. Wolf, Assistant Comptroller General for Accounting and Financial Management, U.S. General Accounting Office; James Cirona, President, Federal Home Loan Bank of San Francisco; accompanied by Michael Patriarca, Director of Regulatory Activities, Federal Home Loan Bank of San Francisco; Darrel Dochow, Executive Director, Office of Regulatory Activities, Federal Home Loan Bank Board; Tom Haupert, Management Consignment Program Manager, American Diversified Savings; Angel Diaz, Board Member, Presidio Savings; Gilbert E. Ynigues, Former Chairman, Presidio Savings and Loan; Mark Weinstein, Professor, University of Southern California; Larry Taggart, Former Commissioner, California State Department of Savings and Loans.

**25 On February 9, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the "other side" of the savings and loan industry. The witnesses were: Jerry Free, President and CEO, First Federal Savings and Loan, Tyler, *112 Tx.; John O'Brien, President, Central Pennsylvania Savings, Shamokin, PA.; George L. Engelke, Jr., Chief Operating Officer, Astoria Federal Savings and Loan, Long Island City, NY.; Richard Haynes, President, Workingman's Federal Savings, Bloomington, IN.; Kim Fletcher, President, Home Federal Savings of San Diego, San Diego, CA.; Adam A. Jahns, Chairman of the Board and President, Cragin Federal Bank for Savings, Chicago, Il.; Don Shackleford, Chairman of the Board, State Savings Bank, Columbus, OH.; J. Robin Harris, Chairman of the Board and Chief Executive Officer, Decatur Federal Savings and Loan Association, Decatur, GA.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

On February 21, 1989, the Banking Committee held hearings on the failure of independent Certified Public Accountants to identify fraud, waste, and mismanagement and assure reporting of the accurate financial position of troubled savings and loans. The witnesses were: Frederick D. Wolf, Assistant Comptroller General, U.S. General Accounting Office; accompanied by David L. Clark, Senior Assistant Director, U.S. General Accounting Office; Robert May, Chairman, American Institute of Certified Public Accountants; accompanied by Philip Chenok, President, American Institute of Certified Public Accountants; and Thomas P. Kelly, Group Vice–President, Professional, American Institute of Certified Public Accountants; William Gladstone, Chairman, Arthur Young; Russel L. Chupik, Managing Partner, Greenstein, Logan, and Company; Thomas A. Myers, President, T.A. Myers and Company; Thomas Bloom, Former Chief Accountant, Federal Home Loan Bank Board.

On February 23, 1989, the Banking Committee held hearings on the Bush Administration's plan to resolve the savings and loan crisis. The witness was: The Honorable Nicholas F. Brady, Secretary of the Department of the Treasury.

On March 8, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The witness was: The Honorable L. William Seidman, Chairman, Federal Deposit Insurance Corporation.

On March 9, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held additional hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The witnesses were: Ballard W. Cassady, Jr., Executive Vice President, Kentucky Bankers Association, Louisville, KY.; accompanied by Larry Lander, Executive Assistant; Jack Rohrer, President, Kentucky League of Savings Institutions, Frankfort, KY.; The Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board; accompanied by Lawrence J. White, Board Member; and Roger F. Martin, Board Member.

**26 On March 10, 1989, the Banking Committee held a field hearing in San Antonio, Texas on the current financial condition of the bank and savings and loan insurance funds, and the need for a joint regulatory effort, especially in Texas. The witnesses were: Frederick D. Wolf, Assistant Comptroller General, U.S. General Accounting Office; George Barclay, President, Federal Home Loan Bank Board of Dallas; James L. Pledger, Commissioner, Texas State Savings and Loan; Craig Stirnweis, Former Deputy Director for Regulatory Affairs, Federal Home Loan Bank of Dallas; Jim *113 Hightower, Texas Commissioner of Agriculture; Jim Mattox, Attorney General of Texas; Wade T. Nowlin, President and CEO, Nowlin Savings–Nowlin Mortgage; Jerry Kelfer, President and CEO, Travis Savings and Loan Assoc.; Earnest Brown, Chairperson, Dallas Association of Community Organizations for Reform Now (ACORN); Paul Willax, Chairman and CEO, Empire of America Federal Savings Bank; John Hildreth, Director, Consumers Union Southwest Regional Office; Kenneth W. Littlefield, Banking Commissioner of Texas.

On March 11, 1989, the Banking Committee continued field hearings in San Antonio, Texas on the current financial condition of the bank and savings and loan insurance funds, the need for a joint regulatory effort, especially in Texas. The witnesses were: L. William Seidman, Chairman, Federal Deposit Insurance Corporation; Charles A. Bowsher, Comptroller General of the United States; Robert Boykin, President, Dallas Federal Reserve Bank; Peter Kraft, Deputy Comptroller, Southwestern District, Office of the Comptroller of the Currency; Dean S. Hoover, Partner, Hoover and Eggleston; John Scarmozi, Southwest Thrift Consultant; John McCrocklin, McCrocklin and Associates; Ned Eichler, Chairman, NRD Eichler and Associates; Stuart Root, Former Director, Federal Savings and Loan Corporation; Gerald J. Ford, Chairman and CEO, First Gibraltar, FSB; Richard L. Buerkle, unemployed; Ann Richards, Texas State Treasurer.

On March 14, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Reform, Recovery, and Enforcement Act of 1989. The witnesses were: John D. Seymour, Member, Board of Directors, American Council of State Savings, Supervisors, and Commissioner, Savings and Loan Commission, Chicago, IL.; Howard B. Brown, Banking Commissioner from the State of Connecticut, on behalf of the Conference of State Bank Supervisors; The honorable Robert L. Clarke, Comptroller of the Currency.

On March 16, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's Proposed Reform, Recovery, and Enforcement Act of 1989. The Subcommittee received

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

testimony from Al Williams, Chairman, Credit Union National Association; Kenneth L. Robinson, President, National Association of Federal Credit Unions; Barney R. Beeksma, Chairman and CEO, InterWest Savings Bank, Oak Harbor, WA. and Chairman, United States League of Savings Institutions; Charles John Koch, President and CEO, Charter One Financial, Inc., Cleveland, OH., and Chairman, National Council of Savings Institutions; Thomas P. Rideout, Vice Chairman, First Union National Bank of North Carolina, Charlotte, N.C., and President, American Bankers Association; Jay Tomson, Chairman, The Citizens National Bank of Charles City, Charles City, IO., and President, Independent Bankers Association of America; George P. Rutland, Chairman and CEO, Northeast Savings, F.A., Hartford, Conn., on behalf of the Financial Assistance Inequity Relief Coalition (FAIR); Frank E. McKinney, Jr., Chairman, Association of Bank Holding Companies.

**27 On March 21, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush *114 Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The witnesses were: Peggy Miller, Consumer Federation of America; Mildred Brown, President, Association of Community Organizations for Reform (ACORN); Sue Wiskowski, National Association of Realtors; Martin Perlman, First Vice President, National Association of Home Builders, Houston, Texas; The Honorable Richard G. Darman, Director, Office of Management and Budget.

On March 22, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Testifying before the Subcommittee were: Joe Whitley, Acting Associate Attorney General, Department of Justice; Honorable Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System.

On March 22, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the adequacy of banking agency examination levels and compensation. The witnesses were: The Honorable L. William Seidman, Chairman, Federal Deposit Insurance Corporation; The Honorable M. Danny Wall, Chairman, Federal Home Loan Bank Board; The Honorable Robert L. Clarke, Comptroller of the Currency; Jeff Dwyer, Conference of State Bank Supervisors.

GAO PRODUCTS ON THE SAVINGS AND LOAN CRISIS

For a number of years the U.S. General Accounting Office (GAO), through its oversight reports and audits of FSLIC's financial statements, has been reporting on the evolving savings and loan crisis. The GAO was among the first to alert Congress of the extent and seriousness of the FSLIC financial situation and the deteriorating financial condition of the industry. As a result, GAO's sustained efforts resulted in numerous testimonies and reports, it has contributed productive guidance on how best to resolve the savings and loan crisis and assure that it is not repeated.

The Committee includes the following list of related GAO products which support the findings and conclusions of this report, as well as many of the reforms addressed in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 as amended and strengthened by the Committee.

List of GAO Products on the Savings and Loan Crisis, fiscal years 1985–1989 *

REPORTS

November 5, 1984—Net Worth Certificate Assistance Programs: Their Design, Major Differences, and Early Implementation (GAO/GGD–85–3)

July 16, 1985—Examination of the Federal Savings and Loan Insurance Corporation's Financial Statements for the Years Ended December 31, 1984 and 1983 (GAO/AFMD–85–60)

*115 September 24, 1985—Thrift Industry Restructuring and the New Worth Certificate Program (GAO/GGD–85–79)

September 30, 1985—Federal Accounting and Auditing Standards Affecting the Private Sector (GAO/AFMD–85–65)

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**28 February 12, 1986—Thrift Industry Problems: Potential Demands on the FSLIC Insurance Fund (GAO/GGD–86–48BR)
April 10, 1986—Thrift Assistance: Industry Restructuring and the Net Worth Certificate Program—Update (GAO/GGD–86–71FS)
June 23, 1986—Thrift Industry: Net Worth and Income Capital Certificates (GAO/GGD–86–100FS)
July 2, 1986—Financial Audit: Federal Saving and Loan Insurance Corporation's 1985 and 1984 Financial Statements (GAO/AFMD–86–65)
September 9, 1986—Thrift Industry: Cost to FSLIC of Delaying Action on Insolvent Savings Institutions (GAO/GGD–86–122BR)
September 30, 1986—Deposit Insurance: Summary of Analysis of Reform Proposals (GAO/GGD–86–32)
September 30, 1986—Deposit Insurance: Analysis of Reform Proposals—Volume I (GAO/GGD–86–32A)
September 30, 1986—Deposit Insurance: Analysis of Reform Proposals—Volume II (GAO/GGD–86–32B)
March 3, 1987—Thrift Industry: The Treasury/Federal Home Loan Bank Board Plan for FSLIC Recapitalization (GAO/GGD–87–46BR)
May 7, 1987—Thrift Industry: Forbearance for Troubled Institutions (GAO/GGD–87–78BR)
May 27, 1987—Financial Audit: Federal Savings and Loan Insurance Corporation's 1986 and 1985 Financial Statements (GAO/AFMD–87–41)
July 13, 1987—Banking Services: Changes in Fees and Deposit Account Interest Rates Since Deregulation (GAO/GGD–87–70)
September 10, 1987—Thrift Industry: The Management Consignment Program (GAO/87–115BR)
March 9, 1988—Thrift Industry: Federal Home Loan Bank Board Advances Program (GAO/GGD–88–46BR)
May 17, 1988—Thrift Industry: Trends in Thrift Industry Performance: December 1977 through June 1987 (GAO/GGD–88–87BR)
May 20, 1988—Issues Involving FHLBB Accountability and Control Policies (GAO/AFMD–88–57)
May 1988—High Yield Bonds: Nature of the Market and Effect on Federally Insured Institutions (GAO/GGD–88–75)
July 5, 1988—Financial Audit: Federal Savings and Loan Insurance Corporation's 1987 and 1986 Financial Statements (GAO/AFMD–88–58)
August 5, 1988—Budget Issues: Information on FDIC and FSLIC Notes Payable (GAO/AFMD–88–71FS)
November 1988—Transition Series Report on the Financial Services Industry Issues (GAO/OCG–89–4TR)
December 12, 1988—Failed Thrifts: No Compelling Evidence of a Need for the Federal Asset Disposition Association (GAO/GGD–89–26)
December 29, 1988—Financial Audit: Federal Asset Disposition Association's 1987 Financial Statements (GAO/AFMD–89–16)
*116 February 2, 1989—CPA Audit Quality: Failures of CPA Audits to Identify and Report Significant Savings and Loan Problems (GAO/AFMD–89–45)
February 21, 1989—Troubled Financial Institutions: Solution to the Thrift Industry Problem (GAO/GGD–89–47)
February 27, 1989—Financial Issues: Information on FSLIC Notes and Assistance Agreements (GAO/AFMD–89–54FS)
March 2, 1989—High Yield Bonds: Issues Concerning Thrift Investments in High Yield Bonds (GAO/GGD–89–48)
**29 March 11, 1989—Failed Thrifts: Bank Board's 1988 Texas Resolutions (GAO/GGD–89–59)
April 13, 1989—Troubled Thrifts: Bank Board Use of Enforcement Actions (GAO/GGD–89–68BR)
TESTIMONY
September 12, 1985—GAO's 1984 Financial Audits of FDIC and FSLIC (before the Subcommittee on Financial Institutions—House Banking Committee)
April 10, 1986—Problems in Reporting by Depository Institutions (before the Subcommittee on Oversight and Investigations—House Energy and Commerce Committee)

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

March 3, 1987—FSLIC Financial Condition and Recapitalization Issues (GAO/T–AFMD–87–4)
June 11, 1987—The Elimination and Possible Reinstatement of FSLIC's Secondary Reserve (GAO/T–AFMD–87–16)
May 19, 1988—FSLIC's Current Financial Condition and Outlook (GAO/T–AFMD–88–12)
September 8, 1988—FSLIC's Use of Notes and Assistance Guarantees (GAO/T–AFMD–88–17)
October 5, 1988—Budgetary Implications of S & L Crisis (GAO/T–AFMD–88–19)
January 13, 1989—Failed Financial Institutions: Reasons, Costs, Remedies and Unresolved Issues (GAO/T–AFMD–89–1)
January 26, 1989—Resolving the Savings and Loan Crisis (GAO/T–GGD–89–3)
February 2, 1989—Resolving the Savings and Loan Crisis (GAO/T–GGD–89–4)
February 21, 1989—The Need to Improve Auditing in the S & L Industry (GAO/T–AFMD–89–2)
February 22, 1989—Resolving the Savings and Loan Crisis (GAO/T–GGD–89–7)
March 10, 1989—Bank and S & L Insurance Funds: Financial Condition and Proposed Reforms (GAO/T–AFMD–89–4)
March 11, 1989—Resolving Texas Thrift Problems (GAO/T–GGD–89–10)
March 14, 1989—Failed Thrifts: GAO's Analysis of Bank Board 1988 Deals (GAO/T–GGD–89–11)
March 22, 1989—Failed Thrifts: Internal Control Weaknesses Create and Environment Conducive to Fraud, Insider Abuse, and Related Unsafe Practices (GAO/T–AFMD–89–4)
April 18, 1989—Government Sponsored Enterprises and the Proposed Resolution Funding Corporation (REFCORP) (GAO/T–AFMD–89–6)
*117 April 19, 1989—Property and Casualty Insurance: Thrift Failures Provide Valuable Lessons (GAO/T–AFMD–89–7)

LETTERS AND MISCELLANEOUS PRODUCTS

May 24, 1985—Fact Sheet on the Net Worth Certificate Program (233128)
August 25, 1988—Letter to Chairman, Subcommittee on Regulation and Business Opportunities, House Committee on Small business, on Liquidation of Assets Acquired from Failed Institutions (B–226353) (233215)
December 9, 1988—Letter to Chairman, Subcommittee on Federal Services, Post Office and Civil Service, Senate Committee on Governmental Affairs, on FADA–Managed Properties (B–231275) (233231)
March 3, 1989—Letter to Congressional Requestors with Information on the Background and Experience of Senior Officials at the FRB, OCC, FDIC, and FHLBB (233228)
March 24, 1989—Letter to Senator Bob Graham, commenting on S. 287 (which separates FSLIC from FHLBB) and S. 288 (which gives FSLIC authority to allow risk-based insurance premiums) (B–232785, GG9–0080) (233241)
March 24, 1989—Letter to Congressman Paul Kanjorski, answering questions regarding viability and sufficiency of the Administration's plan for resolving thrift problems and the impact of premium changes on commercial banks and savings institutions (G9–0088) (233242)
**30 March 24, 1989—Letter to Chairman, Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce, on FHLBB plans to sell FADA (233242)
March 29, 1989—Responses to Questions Received from Senators Riegle, Sasser, regarding GAO's February 2, 1989, Testimony on Problems Facing the Savings and Loan Industry (233241)
March 29, 1989—Letter to Chairman, House Committee on Small Business, Providing Information on Activities of State Chartered Thrifts (G9–0109) (233242)
April 7, 1989—Letter to Chairman, House Committee on Banking and Chairman, of its Subcommittee on Financial Institutions Supervision, Regulation and Insurance, responding to Questions Relating Primarily to Activities of the FDIC (G9–0121) (233241)
April 7, 1989—Response to Questions Received from Senator Riegle regarding GAO's March 14, 1989, Testimony on

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Problems Facing the Savings and Loan Industry (233228)

LEGAL DECISIONS

September 6, 1988—Letter to Rep. Pryor regarding Status of Employees at Federal Home Loan Bank Board (B–226708)
October 11, 1988—CG letter to Rep. Roth regarding FSLIC Notes and Guarantees: Full Faith and Credits (B–233063)
December 12, 1988—Letter to Rep. Pryor regarding Status of Employees at Federal Home Loan Bank Board (B–226708.3)
*118 March 15, 1989—Letter to Rep. Pryor regarding Status of Employees at Federal Home Loan Bank Board (B–226708.4)

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

SECTION–BY–SECTION ANALYSIS

TITLE I—PURPOSES

SEC. 101. PURPOSES.

Section 101 lists the purposes of the bill. The first purpose of the bill, as presented by the Administration, is "to promote a safe and stable system of affordable housing finance through regulatory reform." The remaining purposes, as listed in order are: To improve supervision by strengthening capital, accounting, and other supervisory standards; to establish a relationship of general oversight by the Treasury Department over the Director of the Office of Thrift Supervision (as successor to certain functions and activities of the Federal Home Loan Bank Board and the FSLIC); to establish an independent insurance agency to provide deposit insurance for savers; to put the Federal Deposit Insurance System on a sound financial basis for the future; to create a new corporation, the Resolution Trust Corporation, to contain, manage, and resolve failed savings associations; to provide the necessary private and public financing to resolve failed institutions in an expeditious manner; and, to provide for improved supervision and enhanced enforcement powers and increase criminal and civil money penalties for crimes of fraud against financial institutions and depositors.

TITLE II—FEDERAL DEPOSIT INSURANCE CORPORATION AUTHORITIES AND RESPONSIBILITIES

SEC. 201. FINANCIAL INSTITUTIONS.

Section 201 generally replaces "bank" with "financial institution"—a term that includes both banks and savings associations (thrifts)—throughout the Federal Deposit Insurance Act (FDI Act). It replaces "Federal Home Loan Bank Board" with "Director of the Office of Thrift Supervision." Amendments made to the FDI Act by section 201 generally provide that State savings associations are to be treated as nonmember insured banks for purposes of the FDI Act.

SEC. 202. DUTIES OF THE FEDERAL DEPOSIT INSURANCE CORPORATION.

**31 Section 202 authorizes the FDIC to insure savings associations in addition to banks.

SEC. 203. FDIC BOARD MEMBERS.

Section 203 increases the membership of the FDIC Board of Directors from three members to five. The Comptroller of the Currency and the Director of the Office of Thrift Supervision are ex officio members. The other three are appointive members.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The President may designate, with the advice and consent of the Senate, one appointive member as the Chairperson and one as the Vice Chairperson of the Board of the FDIC, each for a four-year term. Not more than three members of the Board may be from the same political party. Under current law, a Board member may not *119 serve as an officer or director of any insured bank or of a Federal Reserve bank, and may not hold stock in any insured bank. Section 203 provides that, in addition, a Board member may not serve as a director or officer of any insured thrift or of any Federal home loan bank, and may not invest in any insured thrift, or in any bank holding company or savings and loan holding company. The Board members serving on the date of enactment are to complete their terms of office, and the Chairperson is to continue to serve as Chairperson until a successor has been appointed and qualified.

SEC. 204. DEFINITIONS.

Section 204 amends some of the existing definitions in Section 3 of the FDI Act and also provides several new definitions.

The term "bank" is defined to include any national bank, State bank and District bank and any Federal or State insured branch. Section 3(a)(5) of the FDI Act states that any cooperative bank that was insured under the Federal Deposit Insurance Act prior to the enactment of the FIRRE Act is a "bank" for purposes of the FDI Act as amended.

The definition of the term "State bank" is moved from section 3(a) of the FDI Act to section 3(a)(2); no substantive changes are made to the definition.

Section 204 adds new definitions for "savings association," "Federal savings association," and "State savings association" in section 3(b) of the FDI Act. Savings association includes any thrift that is insured by the Federal Savings and Loan Insurance Corporation ("FSLIC") on the effective date of the FIRRE Act, any Federal savings association, and any State savings association. Savings association also includes any corporation that the FDIC considers to be operating substantially in the same manner as a savings and loan association.

Section 3(c), as amended, defines "financial institution" and "insured financial institution." "Insured financial institution" is defined to mean any bank or savings association insured by the FDIC.

Section 3(d) contains definitions of "national member bank," "State member bank," "national nonmember bank," and "State nonmember bank." No substantive changes are made to the current definitions of those terms.

Section 3(j) of the FDI Act, which defines "receiver," is amended to provide that "conserving assets" is one of the functions of a "receiver," and to include "savings associations" among the institutions for which a receiver may act.

**32 Section 3(l), which defines "deposit," is amended to include obligations of savings associations, and to specify that foreign currencies and obligations expressed in foreign currencies do not qualify as "deposits." The Director of the Office of Thrift Supervision is added to the list of bank regulators with which the FDIC Board must consult in any decision on whether to treat other obligations as deposits.

Section 3(m), which defines "insured deposit," is amended to accommodate deposits in savings associations currently insured by the FSLIC.

*120 Section 3(q), which defines the term "appropriate Federal banking agency," is amended to provide that the FDIC is the appropriate Federal banking agency for any State savings association. It adds the Director of the Office of Thrift Supervision as the appropriate Federal banking agency with respect to a Federal savings association or a savings and loan holding company.

Section 204 adds definitions for "State Housing Finance Authority" and "mortgage related assets."

"Financial institution holding company" is defined in section 3(w) of the FDI Act to include any bank holding company and any savings and loan holding company.

Section 204 also adds definitions for "default" and "in danger of default", which are generally defined to be determinations by a public authority for appointment of a conservator or receiver. These concepts are taken from the National Housing Act, and are used throughout the FDI Act in lieu of current references to "closed" banks and banks in "danger of

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

closing."

SEC. 205. INSURED SAVINGS ASSOCIATIONS.

Section 205 provides that all FDIC-insured banks and all FSLIC-insured institutions continue to be insured by the FDIC post date of enactment of the FIRRE Act without application or approval. In addition, this section states that whenever a financial institution files an application with another Federal banking agency that would result in the granting of insurance to the institution, e.g., an application for a national bank charter, the other agency must provide the application to the FDIC for comment (such comment to be made in a reasonable time) and the agency must take the FDIC's comments into account in deciding whether to grant the application. Section 205 provides that, except as otherwise provided in the conversion provisions of Section 206, insurance continues after conversion from an insured Federal financial institution to a State financial institution, and after a merger or consolidation of insured financial institutions.

SEC. 206. APPLICATION PROCESS; INSURANCE FEES.

Section 206 requires State savings associations to apply to the FDIC for deposit insurance. Federal savings associations may apply to the Office of Thrift Supervision, but must also submit an application to the FDIC together with a certificate from the Office of Thrift Supervision. The FDIC Board must consider the first five factors specified in Section 6 of the FDI Act when evaluating the application. Those factors include the risk presented to the Bank Insurance Fund ("BIF") or the Savings Association Insurance Fund ("SAIF"). The FDIC Board (which may not delegate denial authority in the case of such Federal associations) may, after reviewing the application and the certificate, decline to insure the applicant and must provide specific written reasons to the Director of the Office of Thrift Supervision for such denial.

**33 Section 206 provides that any financial institution that becomes insured must pay any entrance fee prescribed by FDIC regulations. The fee is paid into the particular fund, the BIF or the SAIF, depending upon which Fund the institution joins.

*121 Conversions

Prior approval of the FDIC is required for any conversion transaction. There is a five-year moratorium on conversion transactions. Conversion transactions include (i) a change of status (whether by charter conversion or otherwise) from a BIF member to a SAIF member and vice versa, (ii) the merger or consolidation of a BIF member with a SAIF member; and (iii) significant transfers of deposits or assets (generally, transfers of more than 10 percent of deposits or assets) by a BIF member to a SAIF member and vice versa.

The FDIC may consent to a conversion transaction at any time if the FDIC and the Resolution Trust Corporation Oversight Board, when applicable, agree that the conversion transaction is in the best interests of both the BIF and the SAIF. Consent may also be granted to a conversion transaction involving limited branch sales if the sale would assist the seller in meeting a capital standard imposed before August 10, 1987.

An institution participating in a conversion transaction must pay an exit fee as determined by the FDIC. If the institution is exiting the SAIF, the fee is paid to the SAIF or to the Financing Corporation if the Secretary of the Treasury determines that the Financing Corporation has exhausted all other sources of funding. If the institution is exiting the BIF, the fee is paid to the BIF.

An institution participating in a conversion transaction must also pay an entrance fee as determined by the FDIC. When a BIF member converts into a SAIF member, it must pay an entrance fee to the SAIF. When a SAIF member converts into a BIF member, it must pay an entrance fee to the BIF. The fee in each case must be enough to prevent the dilution of the reserves of the Fund to be joined by the institution.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Commonly controlled financial institutions

Section 206 provides for "cross-guarantees" by insured financial institutions that are commonly controlled. Each such financial institution must reimburse the FDIC, as requested, for any loss the FDIC may incur in connection with the failure of or assistance to a commonly owned insured financial institution.

The FDIC is required to estimate the amount of loss it will incur from the default of assistance provided to an insured financial institution and advise each commonly controlled institution of its estimated share of the loss. Procedures for payment are required to be established; the FDIC may require immediate payment. The FDIC is required to reimburse financial institutions for any overpayment and to require additional payments in the case of underpayment.

The cross-guarantees are subordinate in right of payment to deposit liabilities (except those to commonly controlled institutions), to secured obligations, and generally to other liabilities except as specified. The cross-guarantees are superior to obligations or liabilities to other commonly-controlled companies, obligations to shareholders (including a bank holding company or savings and loan holding company or any shareholder or creditor thereof), debts and *122 obligations that are subordinated to depositors and other general creditors, and to contingent claims.

**34 An exception is made for a loan made to a financial institution prior to February 22, 1989, which is secured by a majority of the voting stock of the institution. In such a case, the liability of the institution to the FDIC under the commonly controlled institutions liability provision is limited to the net worth of the financial institution over the outstanding principal and interest on the loan.

The FDIC is given the authority to make rules and regulations and set up administrative procedures as provided in section 11(1) of the FDI Act (12 U.S.C. 1821(1)), as added by section 212 of this Act, for the review of the amount of losses, the liability of individual commonly controlled financial institutions, and the schedule of payments to be made by such commonly controlled institutions. Judicial review is available in accordance with the provisions of the Administrative Procedure Act.

The section establishes a limitation on the rights of private parties to the extent that exercise of such rights would impair the ability of the financial institution to perform its obligations under the cross-guarantee provisions.

An exception from the commonly controlled financial institutions liability provision is made for any existing limited partnership or its affiliates if a registration statement indicating that the partnership intends or intended to acquire one or more insured financial institution was filed with the SEC prior to April 10, 1989.

For the first five years after the effective date of the FIRRE Act, BIF members do not have to reimburse the FDIC for losses or assistance provided in connection with commonly controlled SAIF members, and vice versa.

"Commonly controlled" is defined. Financial institutions shall not be treated as commonly controlled for a period of five years after the date of acquisition (or for such longer period determined by the FDIC) if control was established by virtue of ownership of voting shares acquired in securing or collecting a debt previously contracted and the controlling bank and its insured financial institution affiliates comply with sections 23A and 23B of the Federal Reserve Act.

An exception from the cross-guarantee provisions is made for certain institutions who are in default or in need of assistance solely because of the FSLIC's (or its successor's) failure to meet payment obligations under assistance agreements with or notes to the defaulting or assisted institution.

Finally, an exception is made for any liability to the FDIC that would otherwise arise under this section if the loss is incurred in connection with the default of or assistance to any commonly controlled insured financial institution the principal office of which is located in another State if (i) that State was economically distressed at the time of acquisition and (ii) one or more commonly controlled insured financial institutions in that State had assets in excess of $4 billion in the aggregate and was a member of the Federal Reserve System. The exception applies only during the five year period beginning on the date of acquisition (or such longer period as the FDIC may allow) and only to acquisitions consummated on May 1, 1987 or January 29, 1988.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

*123 SEC. 207. INSURABILITY FACTORS.

**35 Section 207 adds, as a new factor for agencies to consider when evaluating applications for deposit insurance, the risk presented to the BIF or to the SAIF.

SEC. 208. ASSESSMENTS.

Section 208 provides that the FDIC, after reaching agreement with the other three Federal banking agencies, may require insured financial institutions to file additional reports for insurance purposes.

Insurance assessment rates

Section 208 requires the FDIC to set annual insurance assessment rates for BIF members (generally banks) on one hand and for the SAIF members (generally savings associations) on the other.

The section establishes a "designated reserve ratio" for each Fund equal to 1.25 percent of insured accounts. The designated reserve ratio may be increased to not more than 1.50 percent of insured accounts if circumstances exist that raise a probable risk of substantial future losses to the BIF or the SAIF. Such reserves are termed "supplemental reserves" and investment income received on the supplemental reserves must be allocated quarterly to an "Earnings Participation Account" in each Fund. The Earnings Participation Account must be distributed annually to that Fund's members. Supplemental Reserves must be distributed to the Fund's members to the extent not needed to satisfy the designated reserve ratio.

BIF members must pay the current rate (1/12 of 1 percent of insured deposits) until the end of the current year. For the year 1990, the rate is 12/100 of 1 percent. After 1990, the rate remains at 15/100 of 1 percent. SAIF members must likewise pay their current rate (20.8/100 of 1 percent) until December 31, 1990. From January 1, 1991, through December 31, 1993, they pay 23/100 of 1 percent. Finally, on January 1, 1994, this rate becomes 18/100 of 1 percent, where it remains. If a Fund is expected to be below the designated reserve ratio in the following year, premiums above the then applicable rate may be assessed as appropriate to restore the reserve ratio to the designated reserve ratio. However, the rate cannot exceed 35/100 of 1 percent and the increase in the rate cannot exceed the greater of 1/10 of 1 percent or 50 percent of the net premium rate of the prior year. Finally, each institution's premium may not be less than $1,000 annually.

Section 208 clarifies that amounts of premiums paid to the Financing Corporation (FICO) and the Resolution Funding Corporation (REFCORP) under their respective authorities to assess, are to be subtracted from the amounts assessed under this section to be paid to SAIF. This ensures that institutions are not double or triple assessed.

Section 208 authorizes the FDIC to establish assessment categories for BIF members (after December 31, 1991) and for SAIF members (after December 31, 1994) which are related to the risk presented to the respective Fund by the assets, liabilities or activities of the financial institutions in that Fund. The FDIC may establish the assessment categories independently for BIF members and *124 SAIF members. The categorical assessment rates cannot exceed the maximum assessment rates or fall below the minimum assessment rates. Risk-based assessment credits are authorized.

Assessment credits

**36 Section 208 provides for assessment credits. When the FDIC determines, after taking into consideration the respective Fund's expected operating expenses, case resolution expenditures, investment income, and assessment income, that the Fund's reserve ratio is likely to exceed the designated reserve ratio, it must rebate premiums to the Fund's members. The amount of the rebate equals the lesser of the amount necessary to reduce the Fund's reserve ratio to the designated reserve ratio or 100 percent of the net assessment income to be received from the Fund's members in the succeeding year. This section, as all the others dealing with assessments, is Fund specific.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The FDIC must deduct any amount that an institution owes the FDIC from any rebate to be credited to that institution. Furthermore, the FDIC may not rebate any amounts to SAIF members so long as the Financing Corporation is authorized to assess SAIF members for Financing Corporation interest obligations.

Section 208 extends the scope of the Change in Bank Control Act to reach savings associations as well as banks. Elsewhere the FIRRE Act repeals certain sections of Title IV of the National Housing Act, which contain the provisions of the equivalent law currently applicable to savings and loan associations.

Fund eligibility

Generally any savings association, other than any Federal savings bank chartered pursuant to section 5(o) of the Home Owners' Loan Act, which becomes an insured financial institution shall be a SAIF member. Any insured financial institution that is not a SAIF member shall be a BIF member. This section provides that any institution insured by the FDIC as of the enactment of this Act shall be a BIF member; any institution insured by the FSLIC prior to the enactment of this Act shall be a SAIF member.

Any SAIF member may convert to a state-chartered savings bank so long as it remains a member of SAIF.

Secondary reserve

Finally, section 208 provides for the continuation of the secondary reserve offset against savings associations' premiums as provided for in the Competitive Equality Banking Act of 1987.

SEC. 209. TERMINATION OF INSURANCE.

When making any determination regarding the termination of insurance of a solvent savings association, the FDIC is required to consider the extent of the association's low to moderate income housing loans as defined in this section.

SEC. 210. FDIC CORPORATE POWERS.

Section 210 makes technical and conforming amendments to Section 9 of the FDI Act, which generally sets forth the basic corporate powers of the FDIC. This section also amends the fourth paragraph of Section 9 of the FDI Act, to give the FDIC the authority to ***125** sue and be sued, and authority to remove certain State court proceedings to Federal court.

SEC. 211. ADMINISTRATION OF CORPORATION.

Section 211 gives the FDIC the same authority to examine insured savings associations as it has now with respect to insured banks.

SEC. 212. INSURANCE FUNDS; CORPORATION POWERS AS CONSERVATOR OR RECEIVER.

BANK INSURANCE FUND AND SAVINGS ASSOCIATION INSURANCE FUND

****37** Section 212(1)–(4) amends Section 11 of the FDI Act to require the FDIC to insure the deposits of all insured financial institutions, banks and savings associations. Generally, the maximum amount of the insured deposit of any depositor shall be $100,000. Section 11(b)(3) of the FDI Act is amended to provide that amounts held in custodial accounts for the payment of principal, interest, tax, and insurance payments in connection with the mortgage of certain mortgage borrowers shall be insured up to $100,000 per such mortgage borrowers.

Section 11 of the FDI Act is amended to establish two separate insurance funds, which are not to be commingled. BIF is essentially a continuation of the FDIC's existing fund, which until the passage of the FIRRE Act has been known as the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Permanent Insurance Fund. All the assets, debts, obligations, contracts, and other liabilities of the existing FDIC fund are transferred to the BIF. All assessments paid by BIF members (generally banks) are to be paid into this Fund, and the assets of the Fund are to be used in connection with BIF members. The other Fund is the SAIF. All assessments paid by SAIF members (generally thrifts) which are not otherwise committed to the Financing Corporation or Resolution Funding Corporation are to be paid into the Fund, and the assets of the Fund are to be used in connection with SAIF members. In addition, the Treasury is to make the following contributions to the SAIF, subject to available appropriations:

Fiscal year:	Billions
1991	$2.0
1992	3.4
1993	4.6
1994	3.0
1995	4.0
1996	4.0
1997	4.0
1998	4.0
1999	3.0

In the event that case resolution costs run higher than estimated during the period from 1992 through 1999, the Treasury (subject to available appropriations without fiscal year limitation) will contribute additional funds to SAIF that may exceed the levels in the above table so as to cover resolution costs that do not come from other income sources and keep the Fund at a minimum level. The minimum level of the Fund for each of the years 1992 through 1999 is as follows:

Fiscal year beginning October 1:	Billions
1992	$1.0
1993	2.1
1994	3.2
1995	4.3
1996	5.4
1997	6.5
1998	7.6
1999	8.8

Treasury will provide funds to keep the SAIF at the above minimum levels until the earlier of 1999, or the first fiscal year that the SAIF's reserve ratio reaches at least 1.25 percent.

Finally, the FDIC is authorized to borrow from the Federal home loan banks, with the concurrence of the Director of the Office of Thrift Supervision, such funds as the FDIC deems necessary for the use of the SAIF, subject to the conditions specified and the cap on borrowing specified in Section 217. This borrowing authority was previously authorized for the FSLIC. Any borrowings under this section become a specific liability of the SAIF.

Allocation of costs

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**38 Section 212(4) also contains provisions governing the allocation of costs between the two Funds. The section provides that even though the two Funds may not be commingled, the FDIC may conduct its day-to-day operations, including supervisory, regulatory, and receivership activities, on a unitary basis. However, all costs, expenses and receipts incurred or received by the FDIC must be allocated between the Funds. Costs and expenses that can be attributed to one Fund or the other will be borne exclusively by the appropriate Fund; shared costs and expenses will be borne by each Fund proportionately. Personnel, administrative, and other overhead expenses incurred by the FDIC must be charged against one Fund or the other on the basis of whether the expenses were incurred on behalf of banks or savings associations. If incurred on behalf of both, the expense must be allocated between the two Funds on the basis of the cause of the expense, and if this cannot be determined, on the basis of the relative total assets of the two industries.

FDIC as conservator or receiver

The bill, in section 212(5), amends subsections (c) through (j) of section 11 of the FDI Act and adds new subsections (k) through (m). Section 212(5) defines the FDIC's authorities and duties as conservator or receiver. The authorities essentially parallel those heretofore exercised by the FSLIC and the FDIC, and are designed to give the FDIC power to take all actions necessary to resolve the problems posed by a financial institution in default.

Section 212(5) specifies that the authority includes the power as conservator to conduct business, including taking deposits, and performing all functions of the financial institution in its own name; to take necessary action to put the institution in sound and solvent condition; as receiver to merge the institution with another insured financial institution; to organize a Federal savings association to take over assets and liabilities from a failed thrift, or to organize a bridge bank or a new national bank to take over assets and liabilities of any insured financial institution; to transfer assets or liabilities of the financial institution, including those associated with *127 any trust business carried on by the institution, without any further approvals; to determine claims; and to exercise all powers and authorities granted by the Act or incidental thereto.

The bill establishes a claims procedure, with specific deadlines both for creditors and for the FDIC, to be followed in cases where the FDIC has been appointed receiver. Section 212(5) enables the FDIC, when acting as receiver, to request a stay of litigation or other similar proceeding for a period of up to 90 days after its appointment. The appointment of a conservator or receiver can often change the character of litigation; the stay gives the FDIC a chance to analyze pending matters and decide how best to proceed.

Repudiation of contracts

**39 Amended subsection (c) also confirms the historic right of a conservator or receiver to disaffirm or repudiate contracts. In order to repudiate or disaffirm a contract the conservator or receiver must determine that the contract would be burdensome to the failed institution and that repudiation would promote the orderly administration of the financial institution's affairs. If the conservator or receiver repudiates the contract within ninety (90) days from the date the FDIC is appointed receiver or discovers the existence of the contract or lease, there will be no resulting damages for the repudiation against either the conservator or receiver or the financial institution in default.

Similarly, subsection (c) allows the conservator or receiver to enforce contracts that it deems necessary for the orderly execution of its duties as conservator or receiver, notwithstanding any provision of the contract providing for the termination, default, acceleration, or exercise of rights upon, or by reason of, the institution's insolvency or the appointment of a conservator or receiver, except for directors and officers liability insurance contracts and financial institution bonds. The legislation retains current law for such provisions in directors and officers liability insurance contracts and financial institution bonds. The power to enforce contracts does not apply to extensions of credit, or commitments to extend credit, from a Federal home loan bank or Federal Reserve Bank.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Directors and officers liability insurance contracts

The bill as reported by the Committee retains current law for the treatment of exclusionary clauses in directors and officers liability insurance contracts or financial institution bonds. Nothing in subsection (c) impairs or affects any rights a conservator or receiver already appointed had under current law immediately prior to the enactment of this Act or with regard to institutions to which a conservator or receiver is appointed in the future to enforce or recover under a directors or officers insurance policy contract or financial institution bond.

Certain financial contracts

In addition, counterparties to certain Financial Contracts, as defined, including certain securities contracts, commodities contracts, forward contracts, repurchase agreements and swap agreements, may exercise their termination, liquidation, netting and setoff rights under such contracts and related security agreements. The *128 receiver may transfer all claims of a party and its affiliates against the financial institution, all claims of the institution under such contracts, and all assets securing claims under such contracts, thus preserving all netting (if applicable) and setoff rights to security.

Nothing in this subsection is intended to limit in any way the FDIC's ability to interpret through regulation or order the applicability of this provision to such other contracts or transactions as the FDIC deems appropriate, having due regard for market and trade practices and the FDIC is required to prescribe any additional necessary rules and regulations within 180 days of enactment.

**40 Certain resolutions, orders, directives, commitments, and opinion letters (including general counsel's letters) of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation which were in effect as of the date of enactment of the FIRRE Act are to remain in effect in accordance with their terms. The FDIC is bound only with respect to their application to transactions entered into prior to date of enactment.

In general the FIRRE Act provides, as the FDI Act presently provides, that no agreement can form the basis of a claim against the Corporation or the conservator or receiver unless it is in writing and properly approved and maintained in the records of the institution. In the case of Financial Contracts, there is a limited exception; the claimant may rely in good faith on a written representation maintained in the claimant's files. Subsection (c) also protects the holders of legally perfected security interests and new subsection (1) provides for expedited relief for holders of such security interests.

Subsection (c) requires the FDIC to keep and maintain a full accounting with respect to the affairs of the financial institution in default and specifies that the accounting shall be available to the institution's shareholders and other regulatory agencies, including the Secretary of the Treasury and the Comptroller General. The bill also provides that the FDIC may destroy records of a Federal financial institution default after six years from its appointment as receiver.

Subsection (c) permits the FDIC to enter into contracts with State Housing Finance Authorities for the sale of mortgage related assets of the financial institutions in default. The subsection sets forth the factors to be considered by the FDIC in disposing of such assets. Title XIII of the FIRRE Act overrides contrary State and Federal law to allow these HFAs to contract as proposed in this subsection.

Subsection (d), as amended, specifies that, when a receiver is appointed for an insured Federal financial institution (or for an insured District bank or District savings and loan association), the FDIC must be appointed as such receiver. The subsection authorizes, but does not require, the FDIC to accept appointment as conservator for an insured Federal or District financial institution for the purpose of operating the institution, or to serve as conservator or receiver for State institutions either for operating or for liquidation purposes. When the FDIC serves as conservator or receiver for a State institution, it has all the rights, powers and privileges granted to conservators and receivers of State financial institutions *129 under State law in addition to, and not in derogation of, the powers conferred by the FDI Act.

The FDIC as conservator or receiver shall not be subject to the direction or supervision of any other agency or Department in the exercise of its duties (except as may otherwise be provided in this Act). The only exception to the rule is where the FDIC has been appointed conservator for a Federal financial institution by that institution's primary regulator,

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

and the institution continues to operate in conservatorship. In such cases, the FDIC shall be subject to the supervision of that primary regulator.

**41 In addition, subsection (e), as amended, gives the FDIC the power currently available to the FSLIC to appoint itself as sole conservator or receiver of an insured State financial institution under certain conditions. The FDIC may not exercise this power unless it makes each of two findings. First, either (1) that a conservator, receiver or other legal custodian has been appointed for an insured State financial institution, that the appointment has been outstanding for at least 15 consecutive days, and that one or more depositors is unable to obtain withdrawal of his or her deposit, in whole or in part, or (2) that a State financial institution has been closed by or under the laws of any State. Second, that any of the following grounds exist: (1) insolvency in that the assets of the institution are less than its obligations to its creditors and others, including depositors; (2) substantial dissipation of assets or earnings due to any violation or violation of law, rules, or regulations, or to any unsafe or unsound practice or practices; (3) an unsafe or unsound condition to transact business; (4) willful violation of a cease-and-desist order which has become final; or (5) concealment of books, papers, records, or assets of the institution or refusal to submit books, papers, records, or affairs of the institution for inspection to any examiner or to any lawful agent of the FDIC.

Subsection (f) provides for the payment of insured deposits and specifies that payments made on account of a BIF member may only be made from the BIF and that payments on account of a SAIF member may only be made from the SAIF.

Subsection (g) of section 11 of the FDI Act, as amended, provides that, when the FDIC pays insurance to a depositor, the FDIC is automatically subrogated to the depositor's claim against the institution. The automatic right of subrogation now applies only to national banks; this subsection extends it to all insured financial institutions.

The FDIC is allowed to use its Deposit Insurance National Bank powers in the case of failed thrifts as well as in the case of failed banks, but does not otherwise change the role or powers of Deposit Insurance National Banks.

Bridge banks

Subsections (h) and (i) make technical changes in the new bank and bridge bank provisions already part of the FDI Act. The changes clear up some of the subsections' ambiguities and streamline bridge bank operations. New banks and bridge banks may be created from insured banks in default but only a Federal mutual savings association may be created from an insured savings association in default.

*130 While an individual who serves in any capacity with respect to a bridge bank does not thereby become an officer or employee of the United States for purposes of Title 5 of the United States Code, a Federal employee who serves in some capacity with respect to a bridge bank does not thereby lose any such status under Title 5; but Federal employees may not receive additional compensation apart from their Federal compensation. In addition, a bridge bank may be treated as a financial institution in default. Treating a bridge bank as being "in default" makes it clear that the bridge bank is eligible for the provisions applicable to failed and failing institutions (e.g., acquisition by interstate holding companies).

**42 A bridge bank is given three possible one-year extensions of corporate life, not just one such extension as is the case now.

Subsection (j) continues current law by requiring the FDIC to fully consider the adverse economic impact of its liquidation actions on local communities.

Subsection (k) states that claimants against a failed financial institution are only entitled to their pro rata share of the institution's estate. This subsection also permits the FDIC to make additional payments to, or for the benefit of, particular creditors or categories of creditors out of its own resources without becoming obligated to make similar payments to any other claimant or category of claimants. The FDIC may only use the resources of the Fund to which the failed institution belonged in making any such payments.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Subsection (l) authorizes the FDIC to make rules and regulations for the conduct of conservatorships and receiverships, and enables the FDIC to set up a variety of administrative procedures to resolve contested claims, including alternative dispute resolution systems. The agency's determination cannot be appealed but a claimant, after exhaustion of administrative remedies, may choose to present its claim de novo in the District Court or to use an administrative review procedure established by the agency. A notice of disallowance becomes final unless the claimant files an objection within 30 days of the mailing of such notice. Any suit must be brought by the claimant within 60 days after the denial of the claim.

Subsection (l) also requires the FDIC to establish an expedited procedure for claimants with validly perfected security interests.

Finally, the subsection bars courts, to the same extent as the Home Owners' Loan Act does now under existing law, from restraining or affecting the exercise of the powers or functions of the FDIC as conservator or receiver, except at the request of the Board of Directors.

SEC. 213. FSLIC RESOLUTION FUND.

Section 213 creates the FSLIC Resolution Fund. Consistent with the provisions of Title IV of this Act, this Fund is the successor to the existing reserves and assets, debts, obligations, contracts and other liabilities of the FSLIC, and is required to be held separately and not commingled with BIF or SAIF.

The FSLIC Resolution Fund is funded from the following sources in the listed priority: (1) the income generated on the assets transferred to it; (2) the proceeds of the resolution of insolvent thrift institutions*131 which became insolvent prior to December 31, 1988 (to the extent such funds are not required by the Resolution Funding Corporation); (3) the proceeds from borrowings by the Financing Corporation; and (4) until 1992, from the assessments levied on SAIF members and not required by the Financing Corporation or the Resolution Funding Corporation.

Section 213 also provides for additional funding by the Secretary of the Treasury from appropriated funds, if needed.

**43 Any judgment resulting from any civil action or proceeding to which the FSLIC was party prior to its dissolution or any action which is initiated against the FDIC based upon FSLIC actions is limited to the assets of the FSLIC Resolution Fund. The FSLIC Resolution Fund will be dissolved when its debts and liabilities have been satisfied and all its assets have been sold, with remaining funds being covered into Treasury. Any other tangible assets are to be transferred to SAIF.

SEC. 214. AMENDMENTS TO SECTION 12.

This section makes conforming technical changes to Section 12 of the FDI Act, which deals with paying insurance to depositors, the appointment of agents to assist the FDIC in conducting receiverships, and other matters.

SEC. 215. AMENDMENTS TO SECTION 13.

Section 215 specifies that the funds held in each of the specific funds administered by the FDIC must be invested separately, and may not be commingled. Section 215 allows the FDIC to stay legal proceedings involving asset purchases for up to 90 days.

Section 215(3) amends section 13(c) of the FDI Act to permit the FDIC to extend assistance to savings associations.

Section 215(3) amends the "cost test" for FDIC assistance. Under current law, the FDIC may not provide assistance in excess of that amount which the FDIC determines to be reasonably necessary to save the cost of liquidating (unless continued operation is necessary to provide essential banking services). Section 215 would additionally require FDIC to consider the immediate and long-term obligations of the FDIC with respect to any assistance, and also the Federal tax revenues foregone by the government as a result of specific tax benefits granted to acquirers of financial institutions in default or in danger of default.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Section 215 provides that transfers of assets or liabilities associated with any trust business may be effected by the FDIC in connection with any asset purchase transaction without any further State or Federal approval.

Section 215(4) eliminates the requirement for approval by the appropriate State authority and by a court for sales of assets or pledges of assets to secure loans by conservators, receivers or liquidators to the FDIC.

Section 215(4) clarifies the current provision invalidating certain secret agreements against interests of the FDIC. Section 215 makes it clear that these provisions apply to assets that the FDIC acquires as receiver as well as to assets that it acquires in its corporate capacity.

Section 215(5) specifies that the Board of Directors of the FDIC must act by a 75 percent vote (rather than the present unanimous *132 vote) in order to override State objections to an assisted interstate acquisition of an insured financial institution in default with $500,000,000 or more in assets.

Section 215 provides that paragraph (2), the assisted emergency interstate acquisition and paragraph (3), the emergency interstate acquisition of insured banks in danger of default, of subsection (f) apply to the acquisition of a minority-controlled bank by an out-of-State minority-controlled depository institution or holding company without regard to the asset size of the minority-controlled bank.

**44 Section 215 retains current provisions of law governing interstate acquisition of banks, and keeps them separate from those that govern thrifts. It tightens the rules by providing that such acquisitions would be prohibited if they threaten the safety or soundness of the acquirer or would not result in the future viability of the resulting institution.

Section 215(8) transfers the parallel interstate-acquisition provisions relating to thrifts, which now appear at section 408(m) of the National Housing Act, to subsection 13(k) of the FDI Act (with technical and conforming amendments). These rules continue to apply only to savings institutions and are not extended to banks. Section 215 permits an override of the laws of any State that constitute a material impediment to supervisory acquisitions. In authorizing any acquisitions under this section, the FDIC must determine that the acquisition does not present a substantial risk to the safety or soundness of the savings association to be acquired or to the acquiring entity. The section permits a Federal savings association that acquires another savings association pursuant to this provision to hold such savings association as a subsidiary notwithstanding the percentage limitation of section 5(c)(4)(B) of the Home Owners' Loan Act. Dual service by a management official with respect to an institution acquired under this section that would otherwise be prohibited under the Depository Management Interlocks Act may be permitted by the FDIC for no longer than a 10–year period. In exercising override authority with respect to Federal savings associations, the FDIC must obtain the prior concurrence of the Director of the Office of Thrift Supervision.

Provisions of former section 408(m) establishing preferences in approving applications to acquire a failing institution based on the location of the applicant and the type of applicant are deleted. The FDIC is required to give consideration to the need to minimize the cost of financial assistance. In the case of minority-controlled institutions, the FDIC must seek offers from other minority-controlled institutions.

Section 215(8)(k) requires the RTC to consider proposals by SAIF members for assistance pursuant to section 21A of the Federal Home Loan Bank Act before grounds exist for the appointment of a conservator or receiver if the institution is in a "troubled condition" as defined in this section. To be eligible for such assistance the SAIF member must meet certain criteria set forth in the section. The RTC must provide assistance to qualifying members unless it makes a specific finding that a merger or liquidation of the member is feasible and less costly.

*133 SEC. 16. BORROWING AUTHORITY.

Section 216 increases the borrowing authority of FDIC from $3,000,000,000 to $5,000,000,000, and also specifically states that the Secretary of the Treasury must approve any use of the credit line.

SEC. 217. LIMITATION ON BORROWING.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**45 Section 217 clarifies the existing provision specifying that the only kind of non-Federal tax to which the FDIC, in its corporate capacity or as receiver, is subject is a tax on real property. The exemption from taxation extends to the Corporation's property and operations in whatever capacity it is functioning, and particularly as a receiver for a national bank, a branch of a foreign bank, or a savings association (but not as a receiver for a State bank under State law).

Section 217 requires the FDIC to estimate the cost of any obligation, guarantee or other liability before issuance. The FDIC is also required to estimate the aggregate cost to the FDIC of outstanding obligations or guarantees issued and liabilities incurred before enactment of the FIRRE Act. The financial statements of the FDIC must reflect the estimates described above. Section 217 prohibits the amount of notes, debentures, bonds, and similar obligations, including estimated losses for guarantees and other liabilities of the BIF and of the SAIF, respectively, from exceeding the net worth of the fund. An exception is made for obligations, guarantees, and liabilities not to exceed an aggregate amount of $5 billion with the prior approval of the Secretary of the Treasury. However, the FDIC's Treasury "line of credit" must be reduced by a like amount.

SEC. 18. REPORTS.

Section 218 requires the FDIC to report to Congress annually on its operations, activities, budget, receipts and expenditures. Current law provides only that the FDIC's operations are subject to reporting requirements. Section 218 also requires the FDIC to make quarterly reports to the Secretary of the Treasury with respect to the FDIC's financial operating plans and forecasts and its financial condition and reports of operations (including estimates of actual and future spending, and estimates of future noncash obligations) taking into account the FDIC's financial commitments, guarantees and other contingent liabilities.

SEC. 219. REGULATIONS GOVERNING INSURED FINANCIAL INSTITUTIONS.

Section 219 specifies that signs displayed by insured savings associations shall consist of a statement that the deposits are backed by the full faith and credit of the United States Government, a symbol of the American eagle, and a statement that the accounts of each depositor are insured to $100,000. Signs displayed by insured banks may consist of either the items required to be displayed by the FDIC prior to the date of enactment of this Act, or the same sign as that to be displayed by insured savings associations.

The FDIC is to prescribe by regulation the form and manner of display of the signs. The size of signs must be the same as the size of signs displayed by banks as of January 1, 1989. The section requires the FDIC to promulgate regulations to provide that advertisements by BIF or SAIF members may not disparage the condition of either Fund, refer to the length of time that another institution*134 has been a member of a fund or that it was formerly a member of another fund.

**46 Section 219 subjects all insured financial institutions to the Bank Merger Act. The Director of the Office of Thrift Supervision is the responsible agency with respect to mergers where the acquiring, assuming or resulting institution is to be a savings association. Section 219 provides that all insured State financial institutions, other than State member banks or District banks, would be subject to the requirement of prior FDIC consent to reduction of capital.

Subsidiaries of savings associations

Section 219 sets out new rules governing subsidiaries of insured savings associations. Whenever an insured savings association establishes or acquires control of a company, or elects to conduct any new activity through a company that the association controls, the savings association must notify the FDIC and the Director of the Office of Thrift Supervision. Except as provided in section 5(t) of the Home Owners' Loan Act, the savings association must deduct its entire investment in and loans to the company from its own capital for purposes of determining capital adequacy if the company is engaged in activities not permissible for a national bank. The Director of the Office of Thrift Supervision is given rule-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

making authority over subsidiaries' activities.

The FDIC and the Director of the OTS are given the same powers with respect to a savings association's subsidiary as each have with respect to a savings association pursuant to this section 219 or section 8 of the FDI Act. The Director or the FDIC may order a thrift to divest itself of a subsidiary if such subsidiary constitutes a serious risk to the thrift's financial safety or soundness or is inconsistent with sound banking principles or with the purposes of this Act. If the Director or the FDIC so determines, either may order the savings association to divest control of the subsidiary and may take any other corrective measures with respect to the subsidiary.

Section 219 requires the FDIC to determine by regulation, with respect to all State-chartered SAIF members (after consultation with the Director of the Office of Thrift Supervision) that any specific activity (other than any activity permitted to a Federal savings and loan association) poses a serious threat to the SAIF, and may prohibit any such activity. Once the FDIC issues such a regulation, it may order that no SAIF member may engage directly in that activity.

Section 219 further specifies that a SAIF member may not be held liable indirectly for any obligation arising out of the activity of the subsidiary unless the obligation is in writing, is executed by the SAIF member and the party to whom the obligation is owed, is approved by the SAIF member's board of directors or an official committee of the association, and the liability or obligation has been continuously maintained as an official document of the SAIF member.

Section 219 provides an exception from the capital offset provisions for all activities conducted by a subsidiary of an insured savings association if the savings association was in material compliance with its capital requirements on December 31, 1988 and continues*135 to remain in material compliance or adopts and maintains a capital plan acceptable to the Director of the Office of Thrift Supervision or the FDIC, as appropriate. Section 219 also provides an exception from the subsidiary activity notification and capital offset provisions for certain Federal savings banks.

SEC. 220. NONDISCRIMINATION.

**47 This section specifies that the FDI Act is not intended to discriminate against State nonmember banks or against State-chartered thrifts. It also eliminates the provision requiring nondiscrimination on account of having capital stock less than the amount required for Federal Reserve membership.

SEC. 221. RISK MANAGEMENT TRAINING.

This section requires the FDIC to develop and administer training seminars in risk management for its employees and the employees of insured financial institutions. In addition, within a year after date of enactment the FDIC must report back to the Congress on the feasibility and appropriateness of establishing a formalized risk management training program designed to lead to certification of Risk Management Analysts.

SEC. 222. BROKERED DEPOSITS.

This section amends section 3 of the FDI Act to restrict troubled institutions in the use of brokers to increase deposits. Troubled institutions are those insured financial institutions determined by the FDIC not to meet their minimum capital requirements for purposes of the brokered deposit limitation. The bill provides that the FDIC may permit troubled institutions to use brokers, on an institution-by-institution basis or on the basis of different categories to be established by the FDIC, if the use of brokers to increase deposits, in its judgment, does not constitute an unsafe or unsound practice. Troubled institutions may continue to use the services of brokers in raising deposit moneys, so long as deposits are not increased above existing levels as a result of such use. Troubled institutions could continue to increase deposits through other means as long as brokers were not used. However, other parts of the bill (new section 5(t)(A)(ii) of the Home Owners' Loan Act) limit growth by savings associations (but not other classes of financial institutions) regardless of the source of funds.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

TITLE III—SAVINGS ASSOCIATION SUPERVISION IMPROVEMENTS

SEC. 301. DEFINITIONS.

This section revises the definitions section of the Home Owners Loan Act of 1933 ("HOLA") to incorporate the new terms used in the FIRRE Act.

The term "Director" means the Director of the Office of Thrift Supervision.

The term "Corporation" means the Federal Deposit Insurance Corporation.

The term "Office" means the Office of Thrift Supervision.

The term "savings association" means:

—any Federal savings and loan or federal savings bank;

—any State chartered building and loan, savings and loan, homestead association, or cooperative bank; or*136 —any corporation acting in substantially the same manner as a savings association.

In addition, the term includes any institution the accounts of which were insured by FSLIC immediately prior to the enactment of this Act.

The term "Federal association" includes all Federal savings and loan associations and Federal savings banks chartered pursuant to section 5 of the HOLA.

**48 The term "State savings association" means any savings association that is not a Federal savings association or a State bank.

The term "insured savings association" means a savings association which is a member of the Savings Association Insurance Fund (SAIF).

The term "Federal banking agencies" means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation.

SEC. 302. OFFICE OF THRIFT SUPERVISION DIRECTOR.

The Home Owners' Loan Act of 1933 is amended by inserting a new section, "SEC. 2A DIRECTOR OF THE OFFICE OF THRIFT SUPERVISION," after Section 2. Under subsection (a) of the new section, the Office of Thrift Supervision is established.

Subsection (b) provides that the head of the Office of Thrift Supervision shall be the Director of the Office of Thrift Supervision who shall be subject to the general oversight of the Secretary of the Treasury. The Director may prescribe such rules and regulations and issue and enforce such regulations and orders necessary from time to time to carry out the provisions of this Act and all other laws within the jurisdiction of the Director. The Director shall perform the duties of the office and exercise the powers of the office with the degree of autonomy equal to that of the Comptroller of the Currency.

Subsection (c) provides that the Director shall be a citizen of the United States. The Director shall be appointed for a term of 5 years, by the President of the United States, by and with the advice and consent of the Senate. A vacancy in the office of the Director of the Office of Thrift Supervision shall be filled in the same manner as the previous appointment and the new Director shall be appointed only for the remainder of the original term. A Director may serve after the expiration of such term until such Director's successor has taken office.

Subsection (d) prohibits a Director from having a financial interest, either directly or indirectly, in any member of a Federal home loan bank.

Subsection (e) grants the Director all power and authority vested in the Federal Home Loan Bank Board ("Bank Board") immediately prior to enactment of the Financial Institutions Reform, Recovery and Enforcement act of 1989, which are not transferred to another agency under this Act.

Subsection (f) requires the Director to make an annual report to the Congress.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

*137 Subsection (g) clarifies that the Director of the Office of Thrift Supervision is established by law as a new officer of the United States under the authority provided by the second paragraph of section 2 of Article II of the Constitution of the United States of America.

Subsection (h) limits the authority of certain individuals to serve in the capacity of Director of the Office of Thrift Supervision. No individual who was Chairman or a member of the Bank Board on the date of enactment of this Act may; (i) serve as the Director of the Office of Thrift Supervision unless nominated by the President and confirmed by the Senate, and (ii) serve in acting capacity as the Director of the Office of Thrift Supervision or in any other capacity with respect to such position after the end of the 120–day period beginning on the date of enactment of this Act.

**49 Subsection (i) outlines the framework for the staffing of the Office of Thrift Supervision. Not withstanding section 301(f)(1) of title 31, United States Code or any other provision of law, the Director may employ, direct, and fix the compensation and number of such employees, attorneys, and agents as the Director deems necessary to carry out the duties of the Director or of the Office. In fixing compensation levels, the Director shall seek to maintain comparability with the compensation at the other Federal bank regulatory agencies. In addition, the Director may designate who shall serve in the Director's absence, and may delegate to any duly authorized employee, representative, or agent any power vested in the Director by law.

Subsection (j) provides that the Secretary of the Treasury's oversight and direction shall not extend to the credit related or correspondent banking activities of any Federal home loan bank.

Subsection (k) provides that the principal supervisory agent of the Director of the Office of Thrift Supervision in each Federal home loan bank district; (1) may not be the president of a Federal home loan bank, (2) shall report to the chief supervisory official of the Office of Thrift Supervision, and (3) may be removed for cause by the Director of the Office of Thrift Supervision.

Subsection (1) grants the General Accounting Office the authority to audit all activities of the Office of Thrift Supervision.

SEC. 303. SUPERVISION OF SAVINGS ASSOCIATION.

This section creates a new section 3 of the HOLA, establishing the Director's responsibilities as a regulator of savings associations. Section 303 delineates the responsibilities of the Director of the Office of Thrift Supervision and the Federal Deposit Insurance Corporation ("FDIC") for the supervision and regulation of savings associations. It also incorporates into the HOLA certain provisions of the National Housing Act ("NHA").

Federal Savings Associations. New Sec. 3(a) of the HOLA (1.) provides the Director of the Office of Thrift Supervision with the authority to provide for the examination, safe and sound operation and the regulation of Federal savings associations; (2.) authorizes the Director to issue regulations; and (3.) requires the Director to exercise the Director's powers to encourage the provision of housing credit in a manner consistent with the principles of safe and sound operation.

*138 State Savings Associations. New Sec . 3(b) of the HOLA authorizes the FDIC to provide for the examination, safe and sound operation and regulation of State savings associations. Except in those areas where the FDIC applies regulations promulgated by the Director, the FDIC is authorized to issue regulations providing for the supervision of State savings association. In executing its authority the FDIC may use any authority conferred upon it in the Federal Deposit Insurance Act or in any other Act.

New Sec. 3(c) of the HOLA requires the Director of the Office of Thrift Supervision to prescribe uniform accounting and disclosure standards for all savings associations. These standards are to be coordinated with capital standards established by the Director. Savings associations are to be in full compliance with these uniform accounting standards by no later than December 31, 1994. This carries forward the uniform accounting provisions adopted in the Competitive Equality Banking Act of 1987. These regulations shall use generally accepted accounting principles to the same extent as they

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

are used by Federal banking agencies. Except as required by the capital standards, the accounting standards shall not deviate from uniform standards after December 31, 1994.

**50 New Sec. 3(d) HOLA requires that the regulations and policies established by the Director of the Office of Thrift Supervision that govern the safe and sound operation of savings associations are to be no less stringent than those established by the Office of the Comptroller of the Currency.

Section 303(b) preserves, with minor technical changes, former Section 409 of the NHA by transferring this section to new Section 3(e) of the HOLA. As modified, this section provides that insured savings accounts and share accounts held by FDIC-insured savings associations are lawful investments and may be accepted as security for specified public funds of the United States and funds of corporations organized under United States laws notwithstanding limitations upon the investment of, or upon the acceptance of security for the investment or deposit of, such funds.

Section 303(c) transfers section 410 of the NHA pertaining to participation in lotteries to new section 3(f) of the HOLA with conforming amendments. This section prohibits a savings association from dealing in lottery tickets, dealing in bets used as a means of participating in a lottery, announcing, advertising, or publicizing the existence of a lottery or participant/winner of a lottery, or using its offices for such prohibited activities. Savings associations are not prohibited from accepting funds from, or performing any lawful services for, a State operating a lottery.

Section 303(d) transfers section 413 of the NHA relating to disclosures of beneficiaries of federally related mortgage loans to new section 3(g) of the HOLA. Under this provision, savings associations are prohibited from making a federally related mortgage loan to any agent, trustee, nominee, or other person acting in a fiduciary capacity unless the identity of the person receiving the beneficial interest of the loan is revealed at all times to the association. With respect to such loans, the Director of the Office of Thrift Supervision may request the identity of such person and the nature and amount of the loan.

*139 Section 303(e) transfers section 414 of the NHA to new section 3(h) of the HOLA. This section provides that a savings association may take, receive, reserve, or charge on any loan, note, bill of exchange, or other evidence of debt, interest at the greater of (1) a rate not more than one per centum in excess of the discount rate on ninety-day commercial paper in the specified Federal Reserve Bank where the institution is located, or (2) the rate allowed by the laws of the State where such institution is located. If such rate exceeds the rate that would be permitted in the absence of this section, such rate may be employed notwithstanding any State constitution or statute concerning loan related charges, which is thus preempted. The effect of this section is to preserve the current preemption of state usury laws. This section also prescribes penalties for knowingly charging a rate in excess of the "greater" rate permitted in subsection (a) of the provision.

**51 Section 303(f) provides that no savings association may issue securities which guarantee a definite maturity except with the specific approval of the Director or the FDIC as appropriate, nor issue any securities the form of which has not been approved by the appropriate regulator. This section is intended to preserve, as section (3)(i) of the HOLA, a similar provision of section 403(b) of the NHA.

SEC. 304. APPLICABILITY.

This section applies to all savings associations those provisions of the HOLA that either authorize examination by the Director of the Office of Thrift Supervision or the FDIC or proscribe or limit certain association activities, where such prohibitions or limitations are equally appropriate for Federally chartered and State-chartered institutions. Specifically, those provisions deal with the HOLA territorial application (section 7); supervisory authority (section 3) and enforcement authority (section 5(d)—including the authority to recoup the cost of examinations (section 9); capital standards for associations (section 5(s) and (t); restrictions on transactions with affiliates, and loans to insiders (section 11), tying arrangements (section 5(q)), and certain advertising practices (section 12); supervision of savings association holding companies (section 10); rules requiring membership by all savings associations in a Federal home loan bank (section 5(f)); and rules covering conversions from a State to a Federal charter (section 5(i)), from a State savings bank to a Federal

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

savings bank (section 5(o)) and from a mutual savings association to a stock savings association (section 5(p)).

This section would apply only to Federal savings associations those provisions of the HOLA that are relevant to the holders of Federal charters, such as rules authorizing various types of accounts (HOLA section 5(b); investment authority (section 5(c)); qualifications for individuals seeking a Federal charter (section 5(e)); subscriptions of preferred stock and full-paid income shares by the United States (sections 5(g) and (j)); exemption from State taxation (section 5(h)); trust powers (sections 5(l) and (n)); out of State branches (section 5(r)) and District of Columbia savings associations (sections 5(m) and 8). These Federal-charter only delineations are intended to maintain the distinctions between Federal *140 and State-chartered associations that exist under current law or are created by Section 302 of this Act.

SEC. 305. CONFORMING NAME CHANGES.

This section makes terminology changes to existing law to conform to the treatment used in this legislation.

SEC. 306. SAFETY AND SOUNDNESS.

This section amends section 5(a) of the HOLA, by adding language emphasizing the importance of the safe and sound operations of the nation's savings associations to the statute's purpose of providing credit for home financing.

SEC. 307. LOAN LIMITATIONS AND DEPOSITS.

Section 307(a) provides the Director of the Office of Thrift Supervision, in the case of Federal savings associations, or the Chairperson of the FDIC, in the case of a State insured savings association, with the authority to enforce the provisions of section 5 of the HOLA. Section 5 establishes the permissible powers and activities of savings associations.

**52 Section 307(b)(1) reduces the permissible amount of nonresidential real estate loans a savings association may hold from 40 per cent to 20 per cent of the association's assets.

Section 307(b)(2) restates the existing prohibition on a Federal savings association holding commercial loans in an amount that exceeds 10 per cent of the association's assets.

Section 307(b)(3) restates the existing prohibition on a Federal savings association extending unsecured construction loans that exceed the greater of an amount equal to its surplus, undivided profits and reserves or 5 per cent of its assets.

Section 307(c). Under current law, Section 5(b)(1) of the HOLA, savings association are not permitted to offer checking accounts to organizations or entities with which the savings association does not otherwise have a business, corporate, commercial, or agricultural relationship. Section 307(c) removes this restriction, thereby permitting savings association to offer checking accounts to any customer. It also amends current subsection 5(c)(1)(G) of the HOLA to clarify that Federal savings associations may invest in deposits of any type in any financial institution whose deposits are insured by the FDIC.

SEC. 308. SUPERVISORY REVISIONS.

Section 308(a) would delete the majority of the enforcement provisions currently in the HOLA with regard to Federally chartered savings associations. These provisions are subsumed in the enforcement provisions of section 8 of the Federal Deposit Insurance Act, as amended, with regard to all insured institutions for which the Director of the Office of Thrift Supervision or the FDIC is the appropriate regulatory banking agency.

Section 308(b) would transfer the provisions of section 407(m) of the NHA, with conforming amendments, into section 5(d)(1)(B) of the HOLA. Section 407(m) of the NHA provides for routine examination of institutions (and their affiliates) supervised by the Director of the Office of Thrift Supervision or the FDIC their affiliates. In addition, this section provides the Chairperson of the FDIC with certain powers in formal examination procedures, including subpoena*141 power, and the ability to take and preserve testimony under oath. Finally, it authorizes administrative law judges to con-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

duct hearings on enforcement actions.

SEC. 309. RECEIVERSHIPS.

This section amends the current provisions of the HOLA on the appointment of conservators and receivers (Section 5(d)(6) is redesignated as (d)(2)) to clarify that an unsafe or unsound condition to transact business includes, but is not limited to, substantially insufficient capital or an inability to repay debts or obligation as they come due. This section also provides for the appointment of the FDIC rather than the FSLIC as conservator or receiver for both Federally and State-chartered savings associations. It incorporates provisions of section 406 of the NHA setting forth the procedures to be followed in the case of State savings associations without substantive change except with regard to the time for approval of State officials. In that regard, it would cut back from 90 to 30 days the amount of time that must elapse before the Corporation could act in the event that notice of grounds for the appointment of a conservator or receiver for a State savings association has been provided to the appropriate State official and no response has been received.

SEC. 310. TECHNICAL AMENDMENT.

**53 This section would renumber section 5(d)(11) of the HOLA, dealing with rules and regulations on conservatorships and receiverships, as section 5(d)(7). This renumbering is necessary because of the deletion of preceding paragraphs. The renumbered section would also be amended by section 305 of this Act to apply to all savings associations. This section would preserve and renumber section 5(d)(12)(B) and (C) of the HOLA, dealing with penalties that would attach to criminal conduct by employees or agents of savings associations and failure to comply with demands of conservators and receivers, as provided by section 5(d)(8)(A) and (B). This renumbering would be necessary because of the deletion of preceding paragraphs. This section would also renumber section 5(d)(16) of the HOLA, dealing with compliance with monetary transaction record keeping and report requirements by savings associations, as section 5(d)(10). This renumbering would be necessary because of the deletion of preceding paragraphs.

SEC. 311. AMENDMENT TO TITLE V.

Clarifies that holders of withdrawable accounts are to be treated in the same manner as savings account holders or members of a savings association. This section also clarifies that provisions applicable to the board of directors of a savings association are applicable to any governing body of a savings association. This section also repeals section 5(s) of the Home Owners' Loan Act.

SEC. 312. PROVISIONS FOR LOW–TO–MODERATE INCOME HOUSING LENDERS.

This section amends section 5(d)(2) of the Home Owners Loan Act to require that the Director, in making any determination to appoint a conservator, or receiver for a solvent savings association shall take into account and consider the extent of the association's low-to-moderate income housing loans. A low-to-moderate income *142 housing loan is defined as a loan on residential property whose purchase price is no greater than 60 per cent of the median purchase price of single family homes in the area.

SEC. 313. CONVERSIONS.

This section would expand the provisions of section 5(i) of the HOLA regarding the authority of the Director or the Corporation to oversee and approve mutual-to-stock conversions to include State-chartered savings associations. This amendment is required due to the proposed repeal of the NHA and the resulting need to incorporate this authority with respect to mutual to stock conversions of state-chartered savings associations into the HOLA. In addition it incorporates

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

the grievance procedures for the NHA with regard to conversion decisions and makes technical and conforming amendments.

SEC. 314. CAPITAL STANDARDS.

Section 314 amends section 5 of the Home Owner's Loan Act of 1933 by adding a new subsection (t) that requires the establishment of minimum capital standards for all savings associations.

Paragraph (1) of new subsection (t) provides that before the end of the 180–day period beginning on the date of enactment of the Act, the Director of the Office of Thrift Supervision shall by regulation, establish and maintain uniformly applicable capital standards for savings associations. The established standards may take into account any relevant risk, including credit and interest-rate risk. The capital standards prescribed shall be materially equivalent to and no less stringent than the capital standards applicable to national banks, including risk-based capital standards. If the capital standards established by the Director are not the same as capital standards applicable to national banks, the deviation that exist may not make the capital standard for savings associations less stringent than those applicable for national banks.

**54 The Director shall adopt minimum capital standards which require savings associations to maintain a ratio of core capital to assets of 3 percent, as core capital is defined for national banks with the exception of mortgage servicing rights and certain qualifying intangibles.

Any capital standard in effect at any time for a savings association shall treat purchased mortgage servicing rights in the same manner as purchased mortgage servicing rights are treated under regulations prescribed by FDIC with respect to insured State nonmember banks. The FDIC shall treat retained mortgage servicing rights in the same manner as FDIC treats purchased mortgage servicing rights.

Paragraph (2) of new subsection (t) provides that a savings association may include qualifying intangible assets in meeting the minimum core capital requirement to the extent the percentage of core capital which consists of capital other than such qualifying intangible assets is equal to or greater than the percentage applicable with respect to such period:

Period beginning:	Percent
June 1, 1990	50.00
January 1, 1992	66.66
January 1, 1993	75.00
January 1, 1994	87.50
(After) December 31, 1994	100.00

Supervisory goodwill existing on April 1, 1989, and contributed mortgage servicing rights permitted before April 1, 1989, pursuant to a written action of the Federal Home Loan Bank Board shall be treated as qualifying intangible assets and included in capital for the purpose of satisfying the risk-based capital standard.

No savings association may include any qualifying intangible in capital unless the Director determines that the savings association's management is in compliance with all appropriate laws and regulations and is not engaging in activities that would jeopardize the association's safety and soundness or capital position.

Qualifying intangible assets shall have a risk weight of 100 percent for purposes of risk-based capital standards. In addition, any assets subject to loss sharing arrangements or yield maintenance agreements with the FSLIC shall be risk-weighted as mortgage-backed securities in determining capital standards.

Supervisory goodwill existing on the balance sheet of an institution as of April 1, 1989, with respect to any savings association shall be amortized over any period of amortization, not to exceed 20 years, the use of which, by such savings association, for regulatory accounting purposes was not disapproved before such date by the Bank Board, the FSLIC, or

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

any agent of the Bank Board or the FSLIC.

Paragraph (3) of new subsection (t) provides that in general, a savings association's entire investment in, and loans to, any subsidiary company engaged in activities not permissible for a national bank shall be deducted from the capital of the savings association with the exception of (1) those savings associations that had subsidiaries engaged in such activities on December 31, 1988, (2) any investment by a savings association in any subsidiary of such association which is engaged solely in mortgage banking activities, and (3) any loan by such association to such subsidiary. State chartered thrifts with subsidiaries are permitted to maintain their current level of investments in their subsidiaries, provided they meet the capital standards established by the bill and provided the FDIC does not determine that continuation of these activities does not pose a serious risk to the fund. Furthermore, any Federal savings bank chartered as a State savings bank prior to October 15, 1982, or any savings association that acquired its principal assets from a State savings bank prior to such date, is exempted from the capital deduction requirement. For purposes of determining compliance with capital standards the assets and liabilities of any subsidiary of a savings association shall be combined in the assets and liabilities of such savings association.

**55 Paragraph (4) of new subsection (t) provides that all relevant substantive definitions as it relates to capital standards shall be established by the Comptroller of the Currency.

Paragraph (5) of new subsection (t) outlines supervisory restrictions on asset growth that the Director or FDIC is authorized to impose upon any savings association that is unable to meet required capital standards. Prior to June 1, 1990, the Director or FDIC may impose discretionary limitations on the asset growth of a savings association that is unable to meet capital standards.

*144 After June 1, 1990, the Director or FDIC shall impose asset growth restrictions upon any savings association not in compliance with capital standards. The Director or FDIC may permit any savings association to increase its assets in an amount not to exceed the growth of net interest credited to the savings association's deposit liabilities. Such growth is permitted if: (1) the association obtains prior supervisory approval; such growth is fully supported by risk-adjusted and core capital standards at the time including the growth of such assets; (2) all such growth is invested in low-risk assets, which may include first mortgage loans secured by 1– to 4–family residential real property and fully secured consumer loans; and (3) such savings association thereafter maintains a core capital-to-asset ratio no lower than the ratio the savings association had on June 1, 1990.

The Director or FDIC may restrict the asset growth of any institution that is determined to be taking excessive risks or paying excessive interest rates for deposits.

Paragraph (6) of new subsection (t) provides that the Director or FDIC, until June 1, 1990, shall require any savings association not in compliance with the capital standards to submit a business plan acceptable to the Director or FDIC. The business plan must address the need for increased capital; describe the manner in which the savings association will increase capital sufficiently to achieve compliance with all applicable capital standards; and provide that any increase in assets will be fully supported by increases in tangible capital.

After June 1, 1990, the Director or the FDIC shall place any institution that is not in compliance with capital standards under a supervisory agreement which may include restrictions on dividends and compensation. An exception shall apply if the Director or FDIC determines that such association is not, but will be, in compliance with capital standards by the end of the subsequent quarterly reporting period.

Any failure on the part of any savings association to comply with the provisions of the business plan or any supervisory agreement shall be treated as an unsafe or unsound condition or practice.

Paragraph (7) of new subsection (t) provides that any savings association not in compliance with the capital standards may apply to the Director or FDIC for an exemption from any applicable sanctions or penalty for noncompliance which may be imposed. If the application of such savings association is approved, the only sanction or penalty which may be imposed is the growth restriction.

**56 The Director or the FDIC shall deny any application submitted and revoke any prior approval granted if the Dir-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ector or the FDIC finds that the association's failure to meet any minimum capital standards is accompanied by any of the following: (1) a pattern of consistent losses; (2) substantial dissipation of assets; (3) evidence of imprudent management or business behavior; (4) a willful violation of any Federal law, any law of any State to which such association is subject, or any applicable regulation; or (5) any other unsafe and unsound condition or activity, other than the failure to meet such capital standard.

Any application submitted shall be accompanied by a business plan acceptable to the Director or FDIC. The business plan must *145 address the need for increased capital; describe the manner in which the savings association will increase capital sufficiently to achieve compliance with all applicable capital standards; and provide that any increase in assets will be fully supported by increases in tangible capital.

Any institution that has submitted a business plan or has been placed under a supervisory agreement by the Director or FDIC that fails to comply with the provisions of said plan or agreement will be considered to be operating in an unsafe and unsound manner.

No provision of this paragraph shall be construed as limiting any authority of the Director or FDIC under any provision of this Act or any other provision of law, including section 8 of the Federal Deposit Insurance Act, to take appropriate action with respect to any other unsafe or unsound condition or practice.

SEC. 315. LIMITATION ON INVESTMENTS BY SAVINGS ASSOCIATIONS.

Section 5 of the Home Owners' Loan Act of 1933 is amended to require that, in general, a State chartered savings association may not directly acquire or retain an equity investment that is not permissible for a Federal savings association. This provision shall not apply with respect to shares of a service corporation, except as noted below, if (1) the FDIC has determined that the amount invested and the activities engaged in pose no significant risk to the insurance funds and (2) the institution is at all times in compliance with the fully phased-in capital standards.

With respect to the retention of shares of any subsidiary described in section 18(m)(6), the limitation shall not apply to the extent the amount committed is subject to the requirements and limitations which are contained in such section or are imposed by the Director or the FDIC pursuant to such section. If an institution held an equity position on May 1, 1989, it may retain such investment in accordance with regulations established by the FDIC. The FDIC shall direct the divestment of any equity interests not permissible under this section no later than June 1, 1994.

SEC. 316. TECHNICAL AMENDMENT.

This section would replace all references to "association" in section 8 of the HOLA, which deals with District of Columbia savings associations, with "savings association" and all references to "Federal savings and loan association" with "Federal savings association." By doing so, this section would be merely adopting terminology consistent with the overall treatment of such associations in this legislation.

SEC. 317. COST OF EXAMINATION AND REPORTS.

**57 Section 317 adds a new section 9 to the HOLA preserving authority from the NHA to assess the costs of examining savings associations (or affiliates) upon the savings associations (or affiliates) in proportion to their assets or resources. This section also addresses remedies available to the Director of the Office of Thrift Supervision or the FDIC when an affiliate refuses to pay examination costs or refuses to permit examination or provide required information. This section addresses the deposit of funds derived from assessments, the authority of the Director or the Corporation to issue regulations governing the computation and assessment of examination*146 expenses, the authority to assess for the examination of an association's fiduciary activities, and the obligation of savings associations and affiliates to provide the Director or the Corporation with access to information and reports regarding examinations by other public regulatory au-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

thorities. These provisions are intended to be comparable to those governing the Office of the Comptroller of the Currency. This section clarifies that examination assessments are not government or public funds, or appropriated money, and that examination assessments are not subject to apportionment.

SEC. 318. RECOVERY REGULATIONS REPEALED.

This section repeals section 10 of the HOLA and section 416 of the NHA. Those sections permitted the Federal Home Loan Bank Board to provide capital forbearance to certain federal associations and insured institutions.

SEC. 319. CONTINUED EFFECTIVENESS OF APPROVED CAPITAL RECOVERY PLANS.

This section provides that associations and institutions operating under capital plans previously approved pursuant to section 10 of the HOLA or section 416 of the NHA may continue to operate under such plans so long as they remain in compliance with the terms of such plans and continue to supply to the Director or the Corporation, as appropriate, regular and complete reports on their progress in meeting goals under the plans.

SEC. 320. SAVINGS AND LOAN HOLDING COMPANIES.

Section 320(a) transfers the provisions of the Savings and Loan Holding Company Act from the NHA to the HOLA.

Sections 320(b)(1)–(5) make technical and conforming changes to accommodate the transfer of Section 408 of the NHA to Section 10 of the HOLA.

Section 320(b)(5) deletes subsection 408(g) regarding approval of savings and loan holding company indebtedness. This section deletes subsection 408(m) regarding the merger, acquisition or transfer of a troubled savings association. Such transactions would be governed by Section 13(k) of the Federal Deposit Insurance Act as amended by this bill. This section also deletes section 408(s) of the NHA regarding restrictions on the activities of savings and loan company affiliates, including cross-marketing restrictions. Section 321 of this Act establishes a uniform approach to the regulation of transactions between affiliates based on Sections 23A, 23B and 22(h) of the Federal Reserve Act.

**58 Section 320(b)(6). The Competitive Equality Banking Act of 1987 placed limitations on the permissible activities of savings and loan holding companies. Savings and loan holding companies are permitted to engage in activities permissible for a bank holding company or activities that were permitted by regulation of the Federal Home Loan Bank prior to passage March 5, 1987. Current law exempts from these restrictions a savings and loan holding company that controls only one savings and loan if that savings and loan is a qualified thrift lender. Current law also exempts from the restriction savings and loan holding companies which acquired troubled thrifts if those thrifts are qualified thrift lenders. Section 320(b)(6) exempts from these restrictions the acquisition of troubled savings associations by an individual if the savings associations are qualified*147 thrift lenders. This section clarifies that a bank holding company which acquires a savings association would not be considered a savings and loan holding company.

Section 320(b)(7) clarifies that transactions between affiliates in a savings and loan company are subject to the limitations of Section 11 of the HOLA.

Sections 320(b)(8) and (9) permit an individual who controls a savings and loan or a savings and loan holding company to acquire control of a savings association with the written consent of the Director of the Office of Thrift Supervision. In such case, a holding company controlled by the individual is considered a multiple savings and loan holding company unless the acquisition was an acquisition of a troubled savings association.

Sections 320(b)(10), (11) and (13) make modifications to the qualified thrift lender requirements.

Qualified new thrift investment rule.

This section also adds a new requirement to the qualified thrift lender test. This new test is in addition to the test in ex-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

isting law. As a result, in order to avoid the sanctions in existing law and the new sanctions established in this section a savings association must:

(1) maintain 60 per cent of its assets in qualified thrift investments as defined by CEBA, and

(2) 80 per cent of all of the assets acquired after February 28, 1989 must be qualified new thrift investments as defined in this Act.

Definition of qualified new thrift investment.

The following items as defined by section 320, if acquired after February 28, 1989, constitute investments which can be counted toward the qualified new thrift investment.

1. The value of loans, equity or securities acquired by the institution which are related to domestic residential real estate or manufactured housing.

2. The value of property acquired for the use of the institution or its subsidiaries.

3. The value of liquid assets.

4. 50 per cent of the value of residential mortgage loans originated by the institution or a subsidiary and sold within 90 days.

5. The value of consumer loans.

**59 6. The value of equity investment in and loans for the acquisition, development and construction of residential real estate activities of 1–4 family homes that are valued at no more than 60 per cent of the median value of homes constructed in the area. The value of the activity qualifies if not more than 25% of the value of the development is commercial property related to the residential development.

7. The value of residential, church, school, nursing home and small business loans in areas where the credit needs of low and moderate income residents are not being met.

8. The value of equity investments in service corporations which derive 80 per cent of their annual gross revenue from activities related to domestic residential real estate.

*148 9. The value of educational loans.

10. The value of any loan for the purchase or upkeep of residential, church, school, nursing home or hospital property.

Computation of qualified new thrift investment percentage.

In computing the percent of an institution's newly acquired assets which may count toward the qualified new thrift investment, not more than 20 per cent of the assets may consist of the following assets in the aggregate: Liquid assets, mortgages originated and sold within 90 days and consumer loans (number 3, 4 and 5 listed above).

The value of an association's assets described in 6 and 7 above (loans to or equity investments in moderate priced homes development and loans for schools, real property, churches and nursing homes in credit deprived areas) shall be doubled. But in no instance shall more than 20 per cent of the total amount of assets counted toward the qualified new thrift investment test consist of these investments.

Section 320(b)(13) provides that when computing the percentage of the assets that are qualified thrift investments or qualified new thrift investments of a savings association headquartered and operating primarily in Puerto Rico; the value of the following assets shall be doubled:

—personal, family educational or household loans made to persons residing in Puerto Rico,

—loans for the acquisition or improvement of churches, schools, nursing homes or to small businesses located in Puerto Rico; and

—loans for the purchase, acquisition or development of moderately priced one- to four-family residential real estate located in Puerto Rico.

Section 320(c) permits a mutual holding company to pledge the stock of a subsidiary savings association in connection

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

with the formation of a mutual holding company. This section permits the nonvoting stock and up to 50 per cent of the voting stock of a savings association to be issued to any person. It also provides procedures for the liquidation of an insolvent mutual holding company or a savings association owned by a mutual holding company.

SEC. 321. TRANSACTIONS WITH AFFILIATES.

This section adds a new section 11 to the HOLA, which establishes a uniform approach to regulation of affiliate transactions and loans to officers, directors and persons owning more than ten per cent of any class of voting stock of the savings association based on Sections 23A, 23B and 22(h) of the Federal Reserve Act. The Director of the Office of Thrift Supervision would also retain the right to determine for reasons of safety and soundness to impose additional restrictions on transactions with affiliates and insiders of savings associations. In addition, this section limits the amount of loans that savings associations can make to any single borrower to the same standard that applies to national banks. The section also grandfathers approvals by the Bank Board in effect before the date of enactment of transactions involving the purchase or sale of residential, personal, family, or household loans.

**60 *149 This section permits the purchase of certain residential real property loans from an affiliate engaged only in the origination or sale of such loans, the management of the savings institution or incidental activities. Loans which can be purchased by the savings association must meet standards of creditworthiness established by the savings association and the agreement to purchase such loan is subject to the determination of the savings association that such loan meets the creditworthiness standards. In order for a savings association to qualify for this provision the savings association must: (1) on January 1, 1989, and continuously thereafter, maintain only one office that accepts deposits; (2) not originate any residential real property loans; (3) satisfy the capital requirement without delay and without including goodwill; (4) be controlled by a company which stipulated, prior to January 1, 1981, that the controlling company would maintain the net worth of the savings association; and (5) satisfy requirements of the Director of the Office of Thrift Supervision that the controlling company will maintain the capital of the savings association so as to be in compliance with the capital standards. This section also permits the savings association to purchase investment grade mortgage-related securities from an affiliate if the mortgage-related securities are based on a pool of one- to four-family residential real property loans. Section 23B of the Federal Reserve Act is made applicable to the purchase of loans or mortgage-related securities described above. Violation of these provisions shall be enforced in accordance with Section 8 or 18(j) of the Federal Deposit Insurance Act.

SEC. 322. ADVERTISING.

This section provides that no savings association shall carry on any sale, plan, or practices, or any advertising, in violation of regulations promulgated by the Director of the Office of Thrift Supervision. This section would preserve a similar provision found in former Section 403(b) of the NHA.

SEC. 323. TRANSFER OF CERTAIN SECTIONS OF THE FEDERAL HOME LOAN BANK ACT TO THE HOME OWNERS LOAN ACT.

Section 323(a) makes conforming changes to section 5A of the Home Owners Loan Act, redesignates section 5A as section 14 and provides the Director with additional discretion to determine the types of assets that can be held by a savings association in meeting the liquidity standards established by the Director.

Section 323(b) transfers section 8a of the Federal Home Loan Bank Act to the Home Owners Loan Act as a new section 15. This section renames the Savings and Loan Advisory Council as the Thrift Advisory Council and makes conforming changes in the section.

Section 323(c) repeals section 22A of the Federal Home Loan Bank Act. Section 22A was enacted as part of the Com-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

petitive Equality Banking Act and provides for an informal review of supervisory decisions concerning the appraised value of any loan held by a savings association, the appraised value of property serving as collateral for any loan, the classification of any loan or any requirement imposed on the association to reserve against possible loss on such loans. Section 22A also establishes standards for review, provides for an appointment of an independent arbiter, ***150** allows the principal supervisory agent to consolidate related reviews and conduct a single review, provides that the reviews shall be completed before the end of a 45 day period and provides that the informal review is in addition to and not a substitute for any other available review.

SEC. 324. POWERS OF EXAMINERS.

****61** The HOLA is amended by inserting new section, "SEC. 16 POWERS OF EXAMINERS", after Section 15. Examiners appointed by the Director shall be subject to the same requirements, responsibilities, and penalties as are applicable to examiners under title LXII of the Revised Statutes and the Federal Reserve Act, and shall have the same powers and privileges as are vested in such examiners by law.

SEC. 325. AMENDMENT OF ADDITIONAL POWERS OF DIRECTOR.

Section 502 of the Housing Act of 1948 is amended to reflect the creation of the Office of Thrift Supervision and its replacement of the Federal Home Loan Bank Board.

SEC. 326. AMENDMENTS OF TITLE 5, UNITED STATES CODE.

Subsection (a) Compensation of Director, amends Section 5314 of title 5, United States Code to reflect the creation of the Director of the Office of Thrift Supervision and its replacement of the Chairman of the Federal Home Loan Bank Board. Subsection (b) amends section 5373(2) of title 5, United States Code to coordinate with section 2A(i) of the HOLA and section 2B(b) of the Federal Home Loan Bank Act.

SEC. 327. AMENDMENTS TO TITLE 31, UNITED STATES CODE.

Under subsection (a), Subchapter I of chapter 3 of title 31, United States Code is amended by redesignating section 309 as section 310 and inserting a new section 309 after section 308. New section, "309. Office of Thrift Supervision", establishes the Office of Thrift Supervision under section 2A(a) of the HOLA as an office in the Department of the Treasury. Subsection (b) is a conforming amendment which makes adjustments in title 31, United States Code to reflect the creation of the Office of Thrift Supervision. Subsection (c) amends section 714(a) of title 31, United States Code such that the General Accounting Office has explicit authority to perform audits of the Office of Thrift Supervision. Subsection (d) adds new subsection "(e) CERTAIN REORGANIZATION PROHIBITED," to section 321 of title 31, United States Code. The new subsection prohibits the Secretary of the Treasury from merging or consolidating any of the functions or responsibilities of the Office to Thrift Supervision or its Director with the Office of the Comptroller of the Currency or the Comptroller of the Currency. Subsection (e) is a technical and conforming amendment to the Government Control Act, which strikes subparagraph (E), of paragraph (3), from section 9101 of title 31, United States Code.

SEC. 328. PRESERVING MINORITY OWNERSHIP OF MINORITY FINANCIAL INSTITUTIONS.

Section 328(a) requires the Secretary of the Treasury to consult with the Director of the Office of Thrift Supervision and the FDIC on methods for preserving minority owned financial institutions including preference for minority owned institutions in the case of ***151** mergers or acquisitions, providing technical assistance, and encouraging the creation of minority owned institutions.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Section 328(b) requires that every six months the Secretary of the Treasury, Director of the Office of Thrift Supervision and the Chairperson of the FDIC shall report to Congress on actions taken to preserve minority owned financial institutions.

**62 Section 328(c) defines the term minority owned institution and the term minority.

TITLE IV—DISSOLUTION AND TRANSFER OF FUNCTIONS, PERSONNEL, AND PROPERTY OF FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

SEC. 401. DISSOLUTION.

This section provides that the FSLIC will be considered dissolved 60 days after enactment of this Act. It also provides for all insurance and receivership functions of the FSLIC to be performed by the FDIC or the Resolution Trust Corporation after dissolution of the FSLIC. Certain existing rights, duties and obligations in effect before enactment are still valid and the FDIC or the RTC as appropriate may be substituted for the FSLIC in actions or proceedings already commenced by or against the FSLIC.

SEC. 402. CONTINUATION AND COORDINATION OF REGULATIONS.

This section provides that all regulations and orders of the FSLIC or the Bank Board in effect on the date of enactment which relate to insurance of accounts, administration of the insurance fund or conduct of conservatorships or receiverships shall remain in effect and be enforced by the FDIC or the RTC. All other rules and regulations of the FSLIC shall remain effective and enforceable by the Office of Thrift Supervision.

Deposits in savings associations would remain insured under the same provisions for up to 180 days post-enactment. The FDIC is required to review its regulations and those of the FSLIC for deposit insurance coverage before the end of 180 days after the date of enactment and prescribe a uniform set of regulations which shall be applicable to all insured deposits in insured institutions. Terminology in adjustable rate mortgage instruments and certain indexes are changed to conform.

The trust estate of participants in deferred compensation plans on deposit or held in trust is to be evaluated for insurance coverage purposes as if each participant were the beneficiary of an irrevocable trust and the interest of the participant fully vested.

The FDIC is vested with authority to promulgate and enforce rules to prevent actions by savings associations which could pose a serious threat to the Savings Association Insurance Fund or the Bank Insurance Fund.

SEC. 403. FDIC AND RTC PERSONNEL.

This Section provides for the orderly transfer of functions or activities and employees to perform such functions or activities within 60 days of enactment from the Federal Home Loan Bank Board or the FSLIC to the FDIC or the Resolution Trust Corporation. Section 407 parallels section 403 by providing for the transfer *152 of functions and employees, as appropriate, to the Office of Thrift Supervision.

The Director of the Office of Thrift Supervision and the Chairperson of the FDIC are required to jointly determine functions or activities which will be transferred and to identify employees of FSLIC and the Bank Board necessary to perform or support such transferred functions or activities. Each transferred employee is guaranteed a job for a year with comparable pay and status, unless separated for cause. The appointing authority for excepted service positions is transferred as appropriate.

**63 Any employee accepting employment under the transfer may retain any benefit of, or continue membership in, any employee benefit program. If the employee benefit program is not available at the entity to which the employee transferred, the employee is permitted to select an alternate program.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC. 404. DIVISION OF PROPERTY AND PERSONNEL.

This section provides that the Director of the Office of Thrift Supervision and the Chairperson of the FDIC shall divide all property of the FSLIC used to perform the transferred functions or activities between their organizations within 60 days of enactment. Any dispute will be resolved by the Director of the Office of Management and Budget.

SEC. 405. REPEALS.

This section repeals sections 401, 402, 403, 404, 405, 406, 407, 411, 415, and 416 of the National Housing Act. The foregoing does not affect provisions of such sections that have been transferred to other surviving statutory provisions.

SEC. 406. REPORT.

This section requires the FSLIC, prior to its dissolution, to provide by written report to Treasury, the Office of Management and Budget and Congress, a final accounting of its finances and operations.

SEC. 407. OTS PERSONNEL.

This section parallels section 403 and provides for the orderly transfer of functions or activities and employees to perform such functions or activities from the Bank Board and the FSLIC to the Office of Thrift Supervision. Section 703 provides for the transfer of functions and employees to the Federal Housing Finance Board.

TITLE V—FINANCING FOR THRIFT RESOLUTIONS

Subtitle A—Resolution Trust Corporation

Section 501. RESOLUTION TRUST CORPORATION ESTABLISHED.

Section 501(a) amends the Federal Home Loan Bank Act by adding a new section 21A. This section provides for the establishment of the Resolution Trust Corporation ("RT") and describes its powers and authorities.

Subsection (a) of new section 21A provides that the RTC, an instrumentality of the United States, is an "agency" for purposes of the Freedom of Information Act, the Privacy Act, the rulemaking and open meeting provisions of the Administrative Procedure Act and other provisions of subchapter II and ***153** chapter 7 of title 5, United States Code, when it is acting in its corporate capacity and not in its capacity as a conservator or receiver.

Subsection (b) of new section 21A provides that the purpose of the RTC is to carry out a program, under the direction of the Oversight Board, to manage and resolve all cases involving financial institutions, the accounts of which were insured by FSLIC prior to the enactment of the Act, for which a conservator or receiver has been appointed from January 1, 1989, through the date of enactment or is appointed within the three-year period after the enactment of the Act; to manage the assets of the Federal Asset Disposition Association ("FADA") pending its sale or dissolution within 180 days after enactment of the Act; and to perform other authorized functions. The RTC is authorized to take warrants, voting and nonvoting equity, or other participation interests in resolved institutions or assets or properties acquired in connection with resolutions. In carrying out its obligations, the RTC is provided with all of the case resolution and financial assistance rights and powers provided to the FDIC. However, the RTC cannot obligate the FDIC or any funds of the FDIC except to the extent that such authority is specifically provided in other laws, and the RTC cannot provide assistance in excess of the amount determined to be reasonably necessary to save the cost of liquidating an institution.

****64** Paragraph (5) of subsection (b) provides that as of the date of enactment of the Act, the RTC shall be appointed as the conservator or receiver for all institutions for which the FSLIC was appointed as a conservator or receiver after January 1, 1989. The RTC will also assume the position of the FSLIC with respect to the management agreement dated

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

February 7, 1989, among the FSLIC, the Federal Home Loan Bank Board and the FDIC and such agreement shall remain in effect until a new agreement is entered into or, if no new agreement is entered into, for 180 days after enactment. This subsection also provides that the FDIC shall act for and on behalf of the RTC until the earlier of the date on which the Oversight Board or the FDIC certifies to Congress that the RTC has sufficient resources and personnel to perform its functions or 180 days after enactment.

Paragraphs (1)–(5) of subsection (c) of new section 21A provide that the membership of the Oversight Board shall consist of 5 voting members; the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Attorney General of the United States, the Secretary of Housing and Urban Affairs, or their respective designees, and one private sector member, and one nonvoting member, the Chairperson of the FDIC. The private sector member shall with the advise and consent of the Senate be appointed by and shall serve at the pleasure of the President. To be eligible for appointment the private sector member must have substantial experience in the management of large business organizations engaged in real estate, finance, or development activities. The Chairperson of the Oversight Board is the Secretary of the Treasury. The term of each member of the Oversight Board will expire when the RTC is terminated. If any member of the Oversight Board who was appointed as an officer or employee of the United States leaves such position the member's service on the board shall terminate at the time the member leaves such position. Vacancies ***154** on the Oversight Board will be filled in the same manner as the vacant position was previously filled. Members of the Oversight Board are permitted to receive reasonable allowance for necessary expenses of travel, lodging, and subsistence incurred in attending meetings and other activities of the Oversight Board in accordance with subchapter 1 of chapter 57 of title 5 of the United States Code. Members of the Oversight Board shall not receive any additional pay by reason of their service on the Board.

Under paragraph (6), the duty of the Oversight Board is to prescribe by-laws for the RTC, to review and have overall responsibility over the work, progress, management and activities of the RTC, and to disapprove in its discretion any regulations, policies, procedures, guidelines, statements, contract, or other actions of the RTC. It is further required to approve or disapprove any and all agreements for the purchase of assets and assumption of liabilities or any other agreement that results in the acquisition of a financial institution within the jurisdiction of the RTC.

****65** Paragraphs (7)–(10) of subsection (c) provide that three voting members of the Oversight Board constitute a quorum, and all decisions of the Oversight Board require an affirmative vote of at least a majority of the members voting. The Oversight Board is authorized to employ necessary staff, which shall be subject to the terms and conditions of employment applicable to the RTC, provided that the Oversight Board shall utilize to the extent practicable the personnel of the agencies of the voting members of the Oversight Board, without additional compensation, to carry out the Oversight Board's staff functions. Finally, the Oversight Board shall adopt necessary rules and keep permanent and accurate records of its acts and proceedings.

Paragraph (11) of subsection (c) requires the Oversight Board to establish and oversee a minority outreach program to insure that minorities and women and minority-owned and women-owned entities are included to the maximum extent possible in contracts entered into by the RTC. Six months after enactment the Oversight Board shall report to Congress on actions taken to implement the minority outreach program and any recommendations for additional administrative or legislative actions needed to carry out the purposes of the program.

Subsection (d) provides that the Oversight Board shall select a chief executive officer of the RTC to serve at the pleasure of the Oversight Board. The CEO is prohibited for a period of two years after leaving the RTC from holding any office, position, or employment with any institution that participated in any case resolution activity of the Corporation in which the CEO was personally and substantially involved and from engaging in any business transaction concerning such institution or representing, aiding or advising anyone concerning such business transactions with respect to assets involved in case resolution activities.

Subsection (e) provides that the corporate powers of the RTC under the direction of the Oversight Board are to be as follows: to have a corporate seal; to issue capital certificates; to provide for officers, employees, attorneys and agents; subject to the approval of the Oversight Board and subsection (v); to hire and compensate officers and employees of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

RTC, without regard to *155 title 5, United States Code, provided that the compensation and benefits of such employees shall be consistent with and not more than those of the FDIC; with the consent of any executive department or agency, to use the information, services, staff, and facilities of such in carrying out this title; to enter into contracts and modify or consent to the modification of a contract to which the RTC is a party or in which it has an interest under this title; to acquire, hold, lease, mortgage, or dispose of, at public or private sale, real and personal property, and otherwise exercise all the usual incidents of ownership of property necessary and convenient to its operations; to sue and be sued; to use the United States mails on the same terms and conditions as the FDIC; to deposit its securities and its current funds under the terms and conditions applicable to the FDIC under section 13(b) of the Federal Deposit Insurance Act ("FDI Act") and pay fees therefor and receive interest thereon as may be agreed; to make loans as provided in subsection (s) and to exercise such other powers as set forth in this title, and such incidental powers as are necessary to carry out its powers, duties and functions in accordance with this title.

**66 Subsection (f) provides that the RTC has special powers as follows:

1. To enter into contracts with the FDIC and with such other persons or entities, public and private, including State Housing Finance Authorities (as that term is defined in section 3(z) of the FDI Act) as it deems advisable and necessary in order to manage the institutions within its jurisdiction or the assets of such institutions. All contracts with persons or entities other than the Federal Deposit Insurance Corporation are required to be subject to a competitive bid process adopted pursuant to subsection (i)(2)(A). If the RTC contracts with the FDIC then the reimbursement paid to the FDIC may not exceed the actual and reasonable cost incurred by the FDIC for such services.
2. to set the policy on credit standards to be used by an institution within its jurisdiction.
3. to require a merger or consolidation of any institution within its jurisdiction.
4. to organize one or more Federal mutual savings associations, which must be chartered by the Director of the Office of Thrift Supervision and insured by the FDIC through the Savings Association Insurance Fund.
5. to review and analyze all assisted insolvent institution cases resolved by the FSLIC since January 1, 1988, through the date of enactment of this act. The RTC shall actively review all means by which it can reduce costs under existing FSLIC agreements, including the exercise of rights to restructure such agreements, subject only to the monitoring of the Oversight Board. The RTC is required to report to the Oversight Board and to Congress the results and conclusions of its examination, and thereafter the RTC, as permitted by the terms of any resolution agreement and upon the express concurrence of the Oversight Board, may restructure such agreements where savings would be realized therefrom. The costs of such restructuring shall be a liability of the RTC.

*156 6. To exercise all resolution powers and activities authorized to be exercised by the FDIC and the former FSLIC, including but not limited to the powers and authorities with respect to conservatorships or receiverships, to engage in assistance transactions, to collect indebtedness, to enforce liabilities and obligations, and to exercise relevant incidental powers.

Subsection (g) requires the RTC to establish a Real Estate Asset Division ("READ") to develop policies and programs to provide for the management, sale, or other disposition of the real property assets of institutions within the jurisdiction of the RTC, including the real property assets under contract with FADA. The READ has the primary responsibility for the oversight of actions taken by the conservator, receiver or manager of an institution within the jurisdiction of the RTC to the extent that the actions relate to the management, sale or other disposition of real property assets held by such institution. In performing functions under this section the RTC, the Oversight Board and the FDIC are required to utilize the services of private persons, including real estate and loan portfolio asset management, property management, auction marketing and brokerage services, unless such services are unavailable or the utilization of any such service is impracticable or inefficient. READ must also prepare and publish, within 60 days after the enactment of the Act, an inventory of all real property assets of institutions within the jurisdiction of the RTC. This list shall be periodically updated. The Oversight Board must review and approve of all policies and programs of the READ prior to implementation.

**67 Subsection (h) requires the RTC to establish a national advisory board to assist and advise the RTC and the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

READ in the development of policies and procedures for the disposal of real property assets. The national advisory board shall be composed of the chairpersons of regional advisory boards, and three individuals appointed by the Director of the Office of Thrift Supervision, the Chairperson of the FDIC, and the Comptroller of the Currency, respectively.

Paragraph (2) of subsection (h) provides for the establishment of regional advisory boards in Federal home loan bank regions where the Oversight Board has determined that there exists a significant portfolio of real property assets of institutions subject to the jurisdiction of the RTC. The regional advisory boards are to be composed of five persons who represent the views of low- and moderate-income consumers and small business and individuals that are experienced in real property or financial services. These individuals are appointed by the chief executive officer of the RTC and serve for two year terms. Members of the national and regional advisory boards shall serve without compensation except that they may be reimbursed for expenses. The national and regional advisory boards terminate at the time the RTC terminates.

Subsection (i) of new section 21A provides that within 90 days of the enactment of the Act, the RTC shall prescribe rules, policies, procedures and guidelines for the management and disposal of real property assets of institutions within its jurisdiction. These rules must maximize profit, minimize the impact of such transactions on local real estate and financial markets and maximize the availability and affordability of residential real property for low- and moderate-income individuals to the extent consistent with a reasonable ***157** economic return to the RTC and the above goals. Specifically, these policies, procedures, and guidelines shall include the following:

1. procedures for the solicitation and selection of offers for assisted transactions and for the disposition of assets, including provisions for adequate competition and fair treatment of offerors, prohibitions against discrimination on the basis of race, sex, and ethnic group in the solicitation and selection of offers, provisions for the active solicitation of offers from minorities and women, and requirements that unsuccessful offerors be notified within 30 days that their offers have not been accepted and provisions for the debriefing of unsuccessful offerors;
2. guidelines for establishing the market value of assets within the jurisdiction of the RTC based on standard market analysis, valuation, and appraisal practices;
3. procedures requiring the timely consideration of offers to purchase assets and specifying the limited circumstances under which an asset can be disposed of for less than 90% of its appraised value;
4. guidelines for the development of a business plan for the orderly sale of assets in geographic areas that may be adversely affected by such transactions because of local market conditions;

****68** 5. procedures for bulk sale and auction marketing of such assets; and

6. guidelines for the conveyance of assets to units of general local government, States, and public agencies for use in connection with urban homesteading programs approved by the Secretary of Housing and Urban Development.

Paragraph (3) of subsection (i) of new section 21A requires the RTC to document decisions made in the selection and solicitation process and the reasons for the decisions and maintain such documentation.

Subsection (j) provides that all institutions organized by the RTC, i.e. federal mutuals organized pursuant to subsection (f)(4), are subject to conditions and limitations imposed by the RTC on the following: growth of assets; lending activities; asset acquisitions (except as necessary to serve its existing customer base with residential mortgages or consumer loans); use of brokered deposits; and payment of deposit rates. It is further provided that all such savings associations are subject to all laws, rules, and regulations otherwise applicable to them as insured savings associations and will also be subject to their appropriate regulators.

Subsection (k) requires the RTC to convert the Federal Asset Disposition Association to a corporation or other business entity and sell it, through competitive bidding, wind it down, or dissolve it, no later than 180 days after enactment of this Act. When FADA is sold or dissolved, no contract rights with respect to management or disposition of the assets of any insured institution or the FSLIC would be transferred, and the resulting entity cannot use the name "Federal Asset Disposition Association."

Subsection (l) authorizes the RTC to issue nonvoting nontransferable capital certificates to the Resolution Funding Corporation ("REFCORP") in an amount equal to the aggregate amount of ***158** funds provided to it by REFCORP. The

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

RTC may not pay dividends on is capital certificates.

Subsection (m) provides that the RTC, the capital, reserves, and surplus thereof, and the income derived therefrom, are exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by the RTC.

Subsection (n) provides that the RTC is to terminate ten years after this law is enacted. Simultaneous with the termination of the RTC, all its assets and liabilities must be transferred to the FSLIC Resolution Fund, with the net proceeds of the assets being provided to the REFCORP to pay interest costs.

Subsection (o) provides that suits by or against the RTC shall arise under the laws of the United States and can be removed to the District Court of the District of Columbia or if the suit arises out of actions by the RTC with respect to an institution for which a conservator or receiver has been appointed in the district court in which the institution's principal place of business is located.

Subsection (p) provides that guarantees issued by the FSLIC after January 1, 1989, and before the date of enactment of the Act, made in connection with liquidity advances made to savings associations by the Federal Reserve Banks and Federal Home Loan Banks ("Lenders") and guaranteed by the FSLIC during such period, become by operation of law obligations of the RTC. These obligations under the guarantees to the Lenders are required to be paid by the RTC one year after the date of enactment of this Act (to the extent that the loans have not previously been paid) using any funds or other assets available to the RTC. Any claim by any Lender with respect to such obligations shall have priority over all other secured or unsecured obligations of the Corporation. If the resources of the RTC are insufficient to pay these obligations, then the Secretary of the Treasury is authorized to pay the amount of any deficiency to the extent that funds are appropriated for that purpose.

****69** Subsection (q) authorizes the RTC to issue such regulations, policies, procedures, guidelines, or statements as the RTC considers necessary or appropriate to carry out its functions.

Subsection (r) provides the RTC with an emergency line of credit from the Treasury and authorizes and directs the Secretary of the Treasury to loan to the RTC on such terms as may be fixed by the Secretary of the Treasury amounts not exceeding in the aggregate $5,000,000,000 outstanding at any one time.

Subsection (s) provides for homeownership and rental housing opportunities for lower income families. Paragraph (B) authorizes the Corporation to take certain actions upon a decision by the Corporation (or READ) to dispose of eligible residential property.

Subparagraph (1) of paragraph (B) provides that the Corporation shall consult with the appropriate regional advisory board regarding local market conditions as reflected by homeownership opportunities for families not traditionally served in the market area, the need to assist the homeless through permanent housing options, the availability and long-term affordability of housing for lower income families and the vacancy rate in decent housing with rents affordable to a family whose income is not more than 50 percent of the medium income.

***159** This subparagraph also provides that the Corporation shall offer to sell the property to any qualified nonprofit organization, public agency, or lower income family for a 3–month period prior to offering to sell the property to any other qualified purchaser and authorizes the RTC to extend this 3–month period to any longer period if determined by the RTC to be reasonable. Finally, this subparagraph gives the RTC discretion to sell the property to any qualified purchaser only if no qualified nonprofit organization, public agency, or lower income family has made a bona fide offer to purchase the property upon the expiration of a 3–month period or any longer period of time determined by the Corporation to be reasonable.

Subparagraph (2) of paragraph (B) requires that for those offers made during the 90 day right of first refusal period not less than 20 percent of eligible residential dwelling units shall be reserved for occupancy or purchase by, and maintained as affordable for, very low-income families during the remaining useful life of the properties in which the units are located and not less than an additional 15 percent shall be reserved for occupancy or purchase by, and maintained as affordable for, lower income families during the remaining useful life of the properties in which the units are located.

This subparagraph also requires the RTC to give preference among substantially similar offers to the offer involving

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

the highest percentage of dwelling units to be reserved for occupancy or purchase by, and maintained as affordable for, very low-income families and lower income families during the remaining useful life of the property. Purchasers of a property under this subsection are prohibited from terminating the occupancy of any person residing in the property on the date of purchase for purposes of meeting the lower income occupancy requirement applicable to the property. A purchaser shall be considered to be in compliance with this provision if each newly vacant dwelling unit is reserved for lower income occupancy until the lower income occupancy requirement is met. Finally, subparagraph (2) gives the RTC the discretion to waive or reduce the lower income occupancy requirement applicable to any property if the RTC determines that there is no longer a need for housing for lower income families in the area involved.

**70 Paragraph (3) of subsection (s) requires the RTC to agree to sell a property at a price below the net realizable market value to the extent necessary to permit the purchaser to comply with the lower income occupancy requirements applicable to the property. The RTC has discretion to provide a loan to a purchaser of property for all or a portion of the purchase price, which loan shall be secured by a first or second mortgage on the property. The RTC is required to agree to a reduced rate of interest on the loan to the extent necessary to permit the purchaser to comply with the lower income occupancy requirements.

Paragraph (3) also gives the Secretary of Housing and Urban Development discretion to make project-based assistance available under Section 8 of the 1937 Housing Act with respect to purchased properties and requires the Secretary to take such actions as may be necessary to expedite the allocation of assistance. This paragraph also authorizes $284.5 million for Section 8 assistance for *160 ten-year contracts pursuant to the 1937 Housing Act for fiscal year 1990 and authorizes $230.43 million for FY 1990 for Section 8 Moderate Rehabilitation Assistance pursuant to the 1937 Housing Act. This paragraph also authorizes the appropriation of necessary sums for FY 1991.

Paragraph (3) also gives the Secretary of the Department of Agriculture discretion, in accordance with Section 517(d) of the 1949 Housing Act and to the extent of amounts approved in appropriation acts, to guarantee loans made for the purchase of properties that are located in rural areas and gives that Secretary discretion, to the extent of amounts approved in appropriation acts, to enter into rental assistance payment contracts under Section 521(a)(2)(A) of the 1949 Housing Act with respect to properties purchased that are located in rural areas. The Secretary must take such actions as may be necessary to expedite the allocation of assistance. Paragraph (3) authorizes of $60 million for fiscal year 1990 and such sums as may be necessary for fiscal year 1991 for 5–year rental assistance payment contracts under Section 512(a)(2)(A) of the 1949 Housing Act and gives the Secretary discretion to service (directly or through contract) any loan assisted by the Secretary.

Paragraph (4) requires the RTC, for each 3–month period, to publish a listing of eligible residential properties which shall be made available to any person upon request and to be made available for public inspection in the central and regional offices of the Federal home loan banks.

Paragraph (5) of subsection (s) provides that contracts entered into for the purchase of property under this subsection are exempt from competitive bidding requirements.

Paragraph (6) requires the RTC in consultation with the Secretary of the Department of Housing and Urban Development to explore opportunities to work with secondary market entities to provide housing for low and moderate income families; authorizes the Secretary, in a manner consistent with statutory authorities, to work through the Federal Housing Administration and the Government National Mortgage Association and with the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other secondary market entities to develop risk sharing structures, mortgage issuance, and other credit enhancements to assist in the provision of homeownership, rental and cooperative housing opportunities for low-income families; requires that the HUD Secretary shall report in the HUD Annual Report to the House Committee on Banking, Finance and Urban Affairs and the Senate Committee on Banking, Finance and Urban Affairs regarding use of the authority granted under this subsection and shall make recommendations for such additional authorization as the HUD Secretary may deem necessary to implement the objectives of this subsection.

**71 Paragraph (6) also defines several terms used in this subsection. "Eligible residential property" is residential

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

property that is owned by the RTC, or is controlled by the RTC in its responsibilities as a conservator or receiver. "Eligible residential property" must have an appraised value that does not exceed in the case of a 1– to 4–family residence (including a manufactured home), the applicable dollar amount set forth in the first sentence of Section 203(b)(2) of *161 the National Housing Act (without regard to any increase of such amount for high-cost areas); or in the case of a property consisting of more than 4 dwelling units, the applicable dollar amount set forth in Section 221(d)(3)(ii) of the National Housing Act for elevator-type structures (without regard to any increase of such amount for high-cost areas).

"Lower income families" means families and individuals whose incomes do not exceed 80 percent of the median income of the area involved, as determined by the RTC with adjustments for smaller and larger families.

"Nonprofit organization" means a private organization that is approved by the RTC as to financial responsibility and no part of the net earnings of which goes to the benefit of any member, founder, contributor, or individual.

"Public agency" means any Federal, State, local or other governmental entity, including any public housing agency or State housing finance agency.

The term "purchaser" includes any successor in interest of the original purchaser. The term also includes any lower income family which purchases an eligible residential property.

"Rural area" has the meaning given the term in Section 520 of the 1949 Housing Act.

"Very-low income families" means families and individuals whose incomes do not exceed 50 percent of the median income of the area involved, as determined by the RTC with adjustments for smaller and larger families.

Subsection (t) of new section 21A requires the RTC to make public any agreement relating to assisted transactions entered into by the RTC or which arose from insolvent institution cases resolved by FSLIC on or after January 1, 1988. Such agreements must be made public within 30 days after the first meeting of the Oversight Board for agreements already completed or within 30 days after new agreements are entered into unless the Oversight Board decides by unanimous vote of the members that such disclosure is contrary to the public interest. If the Oversight Board decides not to release an agreement, then the reasons for the nondisclosure must be disclosed in a written report which is published in the Federal Register and transmitted to the House of Representatives and the Committee on Banking, Finance and Urban Affairs.

Subsection (u) provides that the RTC cannot employ any individuals or implement any employee compensation and benefit plan unless the Oversight Board submits to Congress a report containing a detailed description of the employment and retention procedures established by the Oversight Board for the RTC and the classification standards, compensation rates and benefits for each class of employee. The RTC cannot employ anyone if within 60 days after the submission of the report a joint resolution is enacted disapproving of any of the proposed employment system, rules, compensation or benefits. Days on which either House of Congress is adjourned for more than three days do not count toward the 60 days. The procedure for House and Senate consideration of this resolution is based on section 208 of the Defense Authorization Amendments and Base Closure and Realignment Act.

**72 *162 Subsection (v) of new section 21A requires the RTC to submit to Congress an annual report including audited financial statement, and a statement of its financial operating plans and forecasts information on its future plans including all future commitments and obligations. This subsection also requires the RTC to submit information on the number of minority and women investors participating in the bidding and the number of successful bids by such investors.

Subsection (w) provides that the RTC's administrative expenses shall be paid from the proceeds received from the REFCORP from the issuance of its obligations.

Subsection (x) provides that in addition to the annual report filed by the RTC, the RTC must also file a semi-annual report that lists the book value of each asset held or managed by the RTC, the Oversight Board, the FDIC and any other governmental entity; a statement of the total book value of assets managed, under contract, by private persons; the number of employees of the RTC, the FDIC, and the Oversight Board, and the total amounts expended for wages and overhead that are attributable to employees involved in contracting with, supervising, or reviewing the performance of private

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

contractors, or managing or disposing of assets; a statement of the total amount expended on private contractors for the management of assets; and a statement of the RTC's efforts to utilize the private sector and to ensure adequate competition and fair treatment of qualified third-parties seeking to provide services to the Corporation.

Section 501(b) provides for a presidentially-appointed independent Inspector General for the RTC.

Section 501(c) amends section 9105 of title 31, United States Code, to require that the Comptroller General audit the RTC annually.

Section 501(d) makes conforming changes in the NHA to allow the RTC to transfer property to an appropriate state agency for use in an urban homesteading program and to provide for reimbursement by the Department of Housing and Urban Development for any properties transferred by the RTC to a state urban homesteading program.

Subtitle B—Resolution Funding Corporation

SEC. 502. RESOLUTION FUNDING CORPORATION ESTABLISHED.

Section 502 amends the Federal Home Loan Bank Act to add a new section 21B that establishes a corporation to be known as the Resolution Funding Corporation ("REFCORP"). The purpose of REFCORP is to provide funds to the RTC.

Under subsection (b) of new section 21B, the Federal Housing Financing Board is required to charter REFCORP no later than five days after the enactment of this Act.

Paragraphs (1)–(5) of subsection (c) provide for a Directorate to manage REFCORP. The Directorate will be composed of three members, one of whom will be the director of the Office of Finance of the Federal home loan banks and two members selected by the RTC Oversight Board from among the presidents of the Federal home loan banks. Each of the two Federal home loan banks presidents***163** will serve for a term of three years. With respect to the initial terms of the two presidents, one such president will be appointed for a term of two years, and one will be appointed for a term of three years. No president of a Federal home loan bank will be selected to serve an additional term on the Directorate unless each of the Federal home loan bank presidents has already served at least as many terms as the president being selected to serve the additional term. When any member of the Directorate leaves the office the member held when appointed to the Directorate, the member's service on the Directorate terminates, and the successor to the office shall serve the remainder of such member's term. The Oversight Board will select a chairperson of the Directorate from among the three members.

****73** Paragraph (6) of subsection (c) provides that REFCORP will have no paid employees, and that the Directorate, with the approval of the Chairperson of the Federal Housing Finance Board, can authorize the officers, employees, or agents of the Federal home loan banks to act for and on behalf of REFCORP to carry out the functions of REFCORP.

Paragraph (7) of subsection (c) provides that all administrative expenses, issuance costs and custodian fees will be paid by the Federal home loan banks. The amount each Federal home loan bank will pay will be determined by the Oversight Board with each bank paying a pro rata amount based upon its required investment in REFCORP. Administrative expenses of REFCORP do not include the interest on its obligations. The terms "issuance costs" and "custodian fees" are defined under subsection (k) of this new section 21B.

Paragraphs (8) and (9) of subsection (c) provide that the Directorate shall be subject to the direction of the Oversight Board and that members of the Directorate shall receive no compensation from REFCORP by virtue of their service on the Directorate.

Subsection (d) of new section 21B provides for the corporate powers of REFCORP. REFCORP, subject to the other provisions of this section and to such regulations, orders and directions as may be prescribed by the Oversight Board, has the power to issue nonvoting capital stock to the Federal home loan banks; to purchase the capital certificates issued by the RTC; to issue debt and pay interest thereon; to impose assessments on the Federal home loan banks and other powers which are not inconsistent with the provisions of this section and which are appropriate to carry out the provisions of this section.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Paragraph (1) of subsection (e) of new section 21B requires each Federal home loan bank to invest in the nonvoting capital stock of REFCORP at such time and in such amounts as prescribed by the Oversight Board. Paragraph (2) provides that the stock issued by REFCORP to the Federal home loan banks will have a par value determined by the Oversight Board and will be transferable only among the Federal home loan banks as prescribed by the Oversight Board at not less than par.

Paragraph (3) of subsection (e) of new section 21B limits the cumulative investment for capitalization of REFCORP by each Federal home loan bank. This limitation will be calculated by adding each bank's reserves on December 31, 1988, plus "undivided profits"*164 on such date, minus amounts invested in the Financing Corporation as of such date, and by adding, for the period December 31, 1988, through December 31, 1991, or such later date as necessary to fund the Funding Corporation Principal Fund pursuant to subsection (g), reserves added after December 31, 1988, plus "undivided profits" accruing after December 31, 1988, minus amounts required to be used to invest in the Financing Corporation after such date.

Paragraph (4) of subsection (e) provides the allocation method for the first $1 billion of aggregate Federal home loan bank contributions to the Financing Corporation and REFCORP. Each bank's share of the first $1 billion is determined by multiplying $1 billion by a specified percentage assigned to that bank.

**74 Paragraph (5) provides for the allocation of funds in excess of the $1 billion described in paragraph (4) required by the Oversight Board to be invested in the capital stock of REFCORP. Each bank's share of this excess amount shall be based on the percentage of total assets of Savings Association Fund members represented at each bank.

Paragraph (6) of subsection (e) provides that if a Federal home loan bank cannot purchase the full amount of stock in REFCORP that it is required to purchase because that amount exceeded the maximum limit set forth in subsection (e)(3), the amount that the bank cannot purchase will be prorated for investment among the remaining Federal home loan banks based on their stock holdings in REFCORP; however, no individual bank will be required to exceed its maximum investment as required by subsection (e)(3). Any Federal home loan bank that did not purcahse the full amount of REFCORP capital stock as required under the formula in paragraph (5) will be required to purchase, annually at the issuance price, from those banks to which such stock was reallocated, the stock originally allocated to it under such paragraph. The amount of such stock repurchases will be determined by the Oversight Board by prorating among the Federal home loan banks, based upon the amount reallocated to and purchased and held by such banks, the amount available for such purchases. Until the restricted bank has fulfilled this repurchase obligation, it is prohibited from paying dividends in excess of one-quarter of its net earnings available for dividends. Such funds not paid out in dividends are to be placed in a reserve account required by the Oversight Board and will not be available for dividends.

Paragraph (7) of subsection (e) provides for additional sources of funds for the Funding Corporation Principal Fund in the event that each Federal home loan bank has exhausted the investment amount applicable with respect to such bank under paragraph (3) (and paragraph (9), described below), as calculated under paragraphs (4), (5) and (6) of subsection (e). Subparagraph (A) of paragraph (7) provides that, first, REFCORP, with the approval of the Board of Directors of the FDIC, will assess each Savings Association Insurance Fund member an assessment as if such assessment was assessed by the FDIC pursuant to section 7 of the FDI Act, as amended. The maximum assessed will be the amount of additional funds necessary to fund the Funding Corporation Principal Fund; provided that the amount assessed under this subparagraph (A) and the amount assessed by the Financing Corporation under section*165 21 of the Federal Home Loan Bank Act will not exceed the amount authorized to be assessed pursuant to section 7 noted above. The Financing Corporation will have first priority to make such assessments. All such amounts assessed under this subparagraph (A) will be subtracted from the amounts authorized to be assessed by the FDIC pursuant to section 7 noted above. Subparagraph (B) provides that to the extent funds available pursuant to subparagraph (A) are insufficient to capitalize REFCORP so as to provide sufficient funds for the Funding Corporation Principal Fund, then the FDIC will transfer to REFCORP from the receivership proceeds of the FSLIC Resolution Fund the remaining amount of funds necessary for such purpose.

**75 Paragraph (8) of subsection (e) defines "undivided profits" as retained earnings minus reserves and amounts held

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

in the "dividend stabilization reserve" as of December 31, 1985.

Paragraph (9) of subsection (e) provides that notwithstanding any other provisions of sections 21, 21A and 21B of the Federal Home Loan Bank Act, the sum of the aggregate annual supplementary capital payments (the sum of the amounts required by (e)(3)(B) to be invested in the capital stock of the REFCORP in excess of the amount specified in (e)(3)(A)) and the supplementary interest payments (as required under (f)(2)(C)) contributed by the banks for each year until REFCORP has no more liabities cannot exceed the lesser of $300,000,000 or 20 percent of the aggregate net earnings of the Federal home loan banks for such year.

Paragraph (1) of subsection (f) of new section 21B authorizes REFCORP, subject to the direction of the RTC, to issue up to $50 billion in debt obligations.

Paragraph (2) of subsection (f) provides for the payment of interest on such obligations. Subparagraph (A) provides that the first source of interest payments are the earnings of assets of REFCORP, other than assets received pursuant to subsection (e) from the Federal home loan banks.

Subparagraph (B) of subsection (f) provides that the second source of interest payments is proceeds received by REFCORP from the RTC from the liquidation of institutions under its management, pursuant to new section 21A of the Federal Home Loan Bank Act, to the extent the proceeds of these institutions are determined by the Oversight Board to be in excess of funds necessary for resolution costs in the near future, and any proceeds from warrants and participation of the RTC.

Subparagraph (C) provides that to the extent the funds available from the RTC are insufficient to cover the amount of interest payments on the obligations, then the Federal home loan banks will pay to REFCORP the aggregate annual amount of $300,000,000, minus the amounts paid by such bank for that year to the Financing Corporation pursuant to section 21 of the Federal Home Loan Bank Act and for the purchase of REFCORP capital certificates. Each bank's individual share is to be determined pursuant to the formulation and limitations of paragraphs (3) through (6) of subsection (e).

Subparagraph (D) provides the net proceeds of all assets of the RTC, upon its dissolution, will be transferred to REFCORP to be used for interest payments before any Treasury funds are used.

***166** Finally, subparagraph (E) provides that to the extent that the Directorate determines after consultation with and approval of the Secretary of the Treasury that REFCORP is unable to pay the interest on any obligation issued under this subsection from the sources of funds under (A), (B), (C), and (D), the Secretary of the Treasury will pay to REFCORP out of funds appropriated for that purpose the additional amount due which will be used by REFCORP to pay such interest. In each case where the Secretary of the Treasury is required to make a payment under this paragraph to REFCORP, the amount of the payment will become a liability of REFCORP that will be repaid to the Secretary of the Treasury upon dissolution of REFCORP to the extent that REFCORP may have any remaining assets. There is authorized to be appropriated to the Secretary of the Treasury, for fiscal year 1989 and each fiscal year thereafter, such sums as may be necessary to carry out this paragraph.

****76** Paragraph (3) of subsection (f) provides that on maturity of an obligation issued by REFCORP under this subsection, the obligation will be repaid by REFCORP from the liquidation of certain zero-coupon bearing instruments held in REFCORP Principal Fund pursuant to subsection (g)(2).

Paragraph (4) of subsection (f) provides that, subject to the terms and conditions as approved by the Oversight Board, the gross proceeds of any obligation issued by REFCORP will be used to purchase capital certificates issued by the RTC or to refund any previously issued obligation the proceeds of which were invested in the capital certificates of the RTC.

Under paragraph (5) of subsection (f) of new section 21B, obligations of REFCORP, issued at the direction of the Oversight Board, will be lawful investments and may be accepted as security for all fiduciary, trust, and public funds, the investment or deposit of which will be under the authority or control of the United States or any officer thereof.

Under paragraph (6) of subsection (f) obligations of REFCORP will be treated in the same manner as Federal home loan bank obligations for purposes of investment, sale, underwriting, purchase, use as collateral, and dealing by financial

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

institutions such as banks, thrifts, and credit unions.

Under paragraph (7) of subsection (f) obligations issued by REFCORP will have the same tax status as obligations of the Federal home loan banks.

Under paragraph (8) of subsection (f) obligations issued by REFCORP will be exempt securities under the provisions of the Federal securities laws administered by the Securities and Exchange Commission.

Paragraph (9) of subsection (f) requires the Oversight Board and the Directorate to ensure that minority-owned and women-owned or controlled commercial banks, investment banking firms, underwriters, and bond counsels throughout the United States have an opportunity to participate to a significant degree in any public or negotiated offering of obligations issued by REFCORP under this section.

Paragraph (10) of subsection (f) of new section 21B provides that the Oversight Board shall require that portion of any public auction*167 of REFCORP obligations as the Board determines is appropriate be offered in minimum denominations not to exceed $1,000 and be made available for purchase on original issue through Federal Reserve banks and branches. REFCORP shall attempt to make the obligations issued under this subsection broadly available to the general public and the Treasury shall examine additional methods of encouraging small investors to participate in public offerings of the obligations of REFCORP and consider the feasibility of encouraging small investor offerings of Treasury obligations.

Under paragraph (11) of subsection (f), REFCORP's obligations will not be obligations of or guaranteed as to principal by the Federal Housing Finance Board, the Federal home loan banks, the United States, or the RTC. However, the Secretary of the Treasury shall pay interest on such obligations as required by the subsection (f) of this section.

**77 Paragraph (1) of subsection (g) of new section 21B provides that, subject to the regulations, restrictions, and limitations prescribed by the Oversight Board, assets not invested in the RTC certificates, and those not needed for current interest payments will be invested in direct obligations of the United States; obligations, participations, or other instruments of, or issued by, the Federal National Mortgage Association or the Government National Mortgage Association; mortgages, obligations, or other securities for sale by, or which have been disposed of by, the Federal Home Loan Mortgage Corporation under section 305 or 306 of the Federal Home Loan Mortgage Corporation Act; or any other security in which it is lawful for fiduciary and trust funds to be invested under the laws of any State.

Paragraph (2) of subsection (g) requires REFCORP to invest the funds received from the Federal home loan banks in noninterest bearing instruments in a segregated account in a sufficient amount such that the total principal payable at maturity will approximately be equal to the aggregate amount of principal on REFCORP's obligations.

Under paragraph (1) of subsection (h) REFCORP will have the same tax status as the Federal home loan banks. In addition, under paragraph (1), the Secretary of the Treasury is authorized to prepare the necessary forms of stock, debentures, and bonds, as approved by the Oversight Board, pursuant to section 23 of the Federal Home Loan Bank Act, for obligations of REFCORP, as the Secretary of the Treasury is also so authorized for obligations of the Federal home loan banks.

Paragraph (2) of subsection (h) of new section 21B provides that the Federal Reserve banks are authorized to act as depositaries for or fiscal agents or custodians of REFCORP.

Paragraph (3) of subsection (h) accords REFCORP, although the corporation will have no Government capital invested in it, the same coverage under the Government Corporations Control Act as the Federal home loan banks are accorded under that Act pursuant to section 11(j) of the Federal Home Loan Bank Act (12 U.S.C. 1431(j)). Thus, audits of REFCORP will be conducted by the General Accounting Office. In addition, the Secretary of the Treasury, a Federal Reserve Bank, or a bank designated as a depository or fiscal agent of the United States Government has the authority to *168 keep REFCORP accounts (although the Secretary of the Treasury can waive the provision regarding accounts). Furthermore, before REFCORP can issue obligations and offer them to the public, the Secretary of the Treasury will prescribe the various conditions to which the obligations will be subject (including the form, denomination, maturity, and interest rate), the way and time the obligations will be issued, and the price for which the obligations will be sold. Finally, before

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

REFCORP could buy or sell a direct obligation of the United States Government, or an obligation on which the principal, interest, or both, is guaranteed, of more than $100,000, the Secretary of the Treasury will have to approve the purchase or sale, although the Secretary can waive this requirement. All of these authorities also pertain to the Federal home loan banks' issuance of debt.

**78 Paragraph (4) of subsection (h) provides that any civil action, suit or proceeding to which REFCORP is a party, will be deemed to arise under the laws of the United States, and the U.S. District Court for the District of Columbia will have original jurisdiction over any such action, suit or proceeding. REFCORP is authorized, without bond or security, to remove any such action, suit or proceeding from a State court to the U.S. District Court for the District of Columbia.

Subsection (i) provides for the termination of REFCORP. REFCORP will be dissolved, as soon as practicable, after the maturity and full payment of all obligations issued by REFCORP. On the effective date of REFCORP's dissolution, the Oversight Board will be authorized to exercise any power of REFCORP in order to conclude its affairs.

Subsection (j) provides that the Oversight Board will be authorized to prescribe such regulations as may be necessary to carry out the provisions of new section 21B including issuing regulations to define the terms used in the section.

Subsection (k) defines certain terms that are used in the section. Paragraph (l) defines "insured savings association" to mean a savings association as such term is defined by section 3(u) of the FDI Act and which was insured by FSLIC immediately prior to the date of enactment of this Act. Paragraph (2) defines the "Oversight Board" to mean the Oversight Board of the RTC, and after termination of the RTC to mean the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Attorney General of the United States, the Secretary of Housing and Urban Development, and the Chairperson of the Federal Deposit Insurance Corporation.

Paragraph (3) defines "Directorate" to be the directorate established as provided in subsection (c)(1).

Paragraph (4) defines "issuance costs" to mean issuance fees and commissions incurred by REFCORP in connection with the issuance or servicing of any of REFCORP's obligations, and includes legal and accounting expenses, trustee and fiscal paying agent charges, costs incurred in connection with preparing and printing offering materials, and advertising expenses to the extent these costs are incurred in connection with issuing any obligation. Paragraph (5) defines "custodian fees" to mean any fee incurred by REFCORP in connection with the transfer of or maintenance of *169 any security in the segregated account established under subsection (g), and any other expense incurred in connection with the establishment and maintenance of the segregated account.

Subsection (l) requires REFCORP to report to Congress annually on its financial status. This report is identical to that required of the RTC. In addition, subsection (l) amends section 9105(a) of title 31 of the United States Code to require the Comptroller General to audit REFCORP annually.

SEC. 503. FINANCING CORPORATION.

This section amends section 21 of the Federal Home Loan Bank Act which established the Financing Corporation. Paragraphs (1)–(8) of this subsection provide for technical amendments to section 21. These changes provide that after the enactment of this Act the Financing Corporation, if necessary, will purchase capital certificates or capital stock issued by the FSLIC Resolution Fund, which will be the successor to the FSLIC ("FSLIC") for some purposes. These certificates and stock will not pay dividends, and any payment on them to the Financing Corporation upon termination of the FSLIC Resolution Fund will be subordinate to any liability to Treasury for the monies it has provided to that fund. These amendments also delete a provision dealing with borrowing limits of the Financing Corporation and make clear that Financing Corporation obligations are not obligations of or guaranteed by the FSLIC Resolution Fund. Finally, these changes conform the Financing Corporation funding mechanism to the language of new section 21B and to the changes in reserve requirements made in title VII.

**79 Section 503 also replaces, with a new provision, the existing subsection (f) of section 21 which authorized the Financing Corporation to assess FSLIC insured institutions for amounts necessary to obtain interest payments for Finan-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

cing Corporation obligations. The new provisions identify the sources of funds for interest payments to be as follows:

Paragraph (1) includes the Financing Corporation assessments which were assessed on insured institutions pursuant to subsection (f) of this section prior to the enactment of this Act.

Paragraph (2) provides that the Financing Corporation, with the approval of the Board of Directors of the FDIC, will assess on each insured Savings Association Insurance Fund member an assessment as if such assessment was assessed by the FDIC with respect to Savings Association Insurance Fund members pursuant to section 7 of the Federal Deposit Insurance Act. The amount assessed hereunder, however, and the amount assessed by REFCORP under section 21B of the Federal Home Loan Bank Act will not exceed the amount authorized to be assessed under section 7 of the FDI Act, and that the Financing Corporation will have first priority to make such assessments. In addition, all assessments made by the Financing Corporation under section (2) and REFCORP under section 21B of the Federal Home Loan Bank Act will be subtracted from the amounts authorized to be assessed by the FDIC under section 7 of the FDI Act.

Paragraph (3) provides that to the extent the funds available pursuant to paragraphs (1) and (2) are insufficient to cover the amount of interest payments on the obligations, then the FDIC will transfer*170 to the Financing Corporation from the receivership proceeds of the FSLIC Resolution Fund the remaining amount of funds necessary for the Financing Corporation to make interest payments only to the extent the funds are not required by REFCORP for the Funding Corporation Principal Fund under section 21B of the Federal Home Loan Bank Act.

Section 503 also defines "insured savings association" to mean a savings association as such term is defined by section 3(u) of the FDI Act and which was insured by the FSLIC immediately prior to the date of enactment of this Act.

SEC. 504. MIXED–OWNERSHIP GOVERNMENT CORPORATION.

Section 504 is a technical amendment to add REFCORP to the list of "mixed ownership" government corporations under the Government Corporations Control Act. Although there will be no government capital invested in REFCORP, this category of "mixed ownership" has been accorded to REFCORP to provide it with parallel legal status to that of the Federal home loan banks.

SEC. 505. WHOLLY–OWNED GOVERNMENT CORPORATION.

Section 505 provides that the RTC it will be a "wholly-owned" government corporation with a status parallel to the legal status previously held by FSLIC. The RTC will be subject to all of the provisions of the Government Corporations Control Act including provisions governing budgets, audits, accounts and the issuance of obligations.

SEC. 506. COMPTROLLER GENERAL AUDIT AND ACCESS TO RECORDS.

**80 Section 506 provides that all agencies, corporations, organizations and other persons of any description which perform any function under the Act, except the Federal Board of Governors of the Federal Reserve System or the Federal Reserve banks with respect to certain functions of these entities, or contract with anyone that performs any function under the Act shall be subject to audit with respect to such activities or contracts. The Comptroller General has the power to enforce document requests. This provision will allow the GAO to audit both the public and private entities that perform functions under title V to assure that the assets and resources within the jurisdiction of the RTC are being managed properly.

SEC. 507. GAO EXAMINATION OF FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION RESOLUTIONS.

New section 507 provides that the GAO shall examine and monitor all insolvent institution cases resolved by FSLIC from January 1, 1988, through the date of enactment and shall provide Congress with estimates of the costs of such

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

agreements. These estimates shall be revised at least every year.

SEC. 508. ESTABLISHMENT OF PRESIDENTIALLY APPOINTED INSPECTOR GENERAL.

Section 508 establishes a presidentially appointed Inspector General for the FDIC.

TITLE VI—THRIFT ACQUISITION ENHANCEMENT PROVISIONS

SEC. 601. ACQUISITION OF THRIFTS BY BANK HOLDING COMPANIES.

Section 601 amends the Bank Holding Company Act to specifically permit the Federal Reserve Board to allow bank holding companies*171 to acquire any savings association, not only failed or failing ones as the Board currently permits. The section also specifies that effective immediately the Board shall not impose restrictions on transactions between the savings association and its holding company affiliates other than those imposed generally by the affiliate transactions statutes at sections 23A and 23B of the Federal Reserve Act or other applicable statutes. In addition, Section 601 requires the Board to modify the conditions imposed in any previous acquisitions of savings associations by bank holding companies to eliminate application of "tandem operations" restrictions.

Section 601 contains a specific provision permitting the contemplated sale of a particular shell savings and loan association charter to a bank holding company. The present owner is required by Federal statute to divest the savings and loan association charter. Section 601 permits the savings and loan association to convert into a commercial bank.

SEC. 602. INVESTMENTS BY SAVINGS AND LOAN HOLDING COMPANIES IN UNAFFILIATED THRIFT INSTITUTIONS.

Section 602 amends the provisions governing savings and loan holding companies (section 408 of the National Housing Act, 12 U.S.C. 1730a, in current law; as transferred into the Home Owners' Loan Act in Title III of the FIRRE Act) to allow a savings and loan holding company to hold up to 5 percent of the voting shares of a savings association or savings and loan holding company that is not a subsidiary. Current law prohibits any such ownership in savings associations other than a controlling ownership. Current law concerning acquisitions by multiple savings and loan holding companies is retained.

**81 A holding company can own more than 5 percent of such shares pursuant to the following exceptions added by section 602:

(1) acquisition of shares in connection with a qualified stock issuance (as defined in Section 604) if approved by the Director of the Office of Thrift Supervision;

(2) acquisition by an insurance company of shares of a savings and loan holding company described in section 10(c)(3) of the Home Owners' Loan Act (formerly section 408(c)(3) of the National Housing Act) so long as the investment is passive;

(3) acquisition of shares of a savings association in connection with an underwriting in the ordinary course of an underwriting business or shares held in an account solely for trading purposes;

(4) shares held as a bona fide fiduciary;

(5) shares acquired in securing or collecting a debt previously contracted for a two year period, or for an additional time not exceeding three years if the Director permits; and

(6) shares over which no control is held other than control of voting rights acquired in the normal course of a proxy solicitation.

SEC. 603. TECHNICAL AMENDMENT TO THE BANK HOLDING COMPANY ACT.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Section 603 amends the Bank Holding Company Act (12 U.S.C. 1841) to define the terms "insured institution" and "savings association." The definition reflects amendments made in Title III of *172 the bill to section 10 of the Home Owners' Loan Act (formerly section 408 of the National Housing Act).

Section 603 amends section 4(f)(2)(A)(ii) of the Bank Holding Company Act by adding the following exceptions for certain acquisitions which would otherwise result in the acquiring company being treated as a bank holding company under that act:

(1) shares acquired in a bona fide fiduciary capacity whether with or without the sole discretion to vote such shares;

(2) shares acquired solely for the benefit of employees of the company controlling the grandfathered bank or any subsidiary of the company and the beneficiaries of the employees;

(3) shares over which no control is held other than control of voting rights acquired in the normal course of a proxy solicitation;

(4) shares acquired in securing or collecting a debt previously contracted for a two year period, or for an additional time not exceeding three years if the Federal Reserve Board permits.

SEC. 604. PURCHASE OF MINORITY INTEREST IN UNDERCAPITALIZED SAVINGS ASSOCIATIONS BY OTHER SAVINGS AND LOAN HOLDING COMPANIES ALLOWED.

Section 604 amends section 10(a) of the Home Owners' Loan Act (formerly section 408(a) of National Housing Act) to permit savings and loan holding companies, subject to the approval of the Director of the Office of Thrift Supervision, to acquire in connection with a qualified stock issuance up to 25 per cent of the voting shares of an undercapitalized savings association or savings and loan holding company without being regarded as having control of such undercapitalized savings association or savings and loan holding company.

**82 A stock issuance is a qualified stock issuance under section 10(q) of the Home Owners' Loan Act if:

(1) the shares are issued by an undercapitalized savings association or by a savings and loan holding company which controls an undercapitalized savings association if the holding company is legally obligated to contribute the net proceeds from the issuance of the stock to the capital of an undercapitalized savings association subsidiary;

(2) all shares are previously unissued or treasury shares;

(3) all shares issued are purchased by a savings and loan holding company that is registered under 10(b)(1) of the Home Owners' Loan Act;

(4) the acquisition is approved by the Director;

(5) the stock is purchased with cash only;

(6) each savings association subsidiary (except those acquired in a transaction pursuant to section 13 of the Federal Deposit Insurance Act) of the acquiring savings and loan holding company has a capital to assets ratio of not less than 6.5 percent; and

(7) immediately after the stock issuance, the acquiring savings and loan holding company owns less than 25 percent of the outstanding voting stock of the issuing undercapitalized savings association or savings and loan holding company.

The section provides that the Director of the Office of Thrift Supervision shall not require additional capital commitments by the *173 acquiring holding company. However, the Director may impose such other restrictions as the Director deems to be appropriate, including prohibitions on affiliate transactions and a limitation on dividends paid by the undercapitalized savings association.

An application pursuant to this section shall be deemed approved if not disapproved by the Director within 90 days of receipt.

An undercapitalized savings association is one whose assets exceed its liabilities and which has regulatory capital (after deducting any subordinated debt, intangible assets, and any deferred, unamortized gains or losses) of less than 5 percent of assets.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The Director is required to take into consideration the financial and managerial resources and future prospects of the acquirer and the savings association or holding company that is offering the qualified stock issuance. The Director may not approve any proposed purchase which would result in a monopoly, or would have other significant anti-competitive effects.

Section 10(c) of the Home Owners' Loan Act (formerly section 408(c) of the National Housing Act) is amended to include ownership of stock acquired in connection with a qualified stock issuance as a permissible activity for a savings and loan holding company.

The Depository Institution Management Interlocks Act is amended to permit a management official of the acquiring savings and loan holding company to act as a management official of the undercapitalized savings association or holding company, if the Director so permits.

Finally, Section 604 amends the Bank Holding Company Act to permit certain companies that are not treated as bank holding companies under that act because they own grandfathered banks to retain their exempt status if:

**83 (1) they acquire an interest in a savings association or savings and loan holding company pursuant to a qualified stock issuance;

(2) they acquire a savings association (or any shares of a savings association) from the RTC, the FDIC or the Director of the Office of Thrift Supervision, whether in any such Corporation's corporate capacity or as conservator or receiver; or

(3) they acquire a savings association that has been found to be in danger of default.

SEC. 605. POWER OF DIRECTOR OF THE OFFICE OF THRIFT SUPERVISION TO REGULATE SAVINGS AND LOAN HOLDING COMPANIES.

Section 10(b) of the Home Owners' Loan Act (formerly section 408(b) of the National Housing Act) is amended by adding a provision to state that insofar as State law is concerned, the Director is solely authorized to provide for the organization, examination, operation, and regulation of each savings and loan holding company and subsidiary thereof, other than a State-chartered savings association. Each savings and loan holding company and subsidiary thereof (other than a bank) shall be subject to examinations by the Director. The cost of examinations shall be assessed against and paid by the holding company.

*174 TITLE VII—FEDERAL HOME LOAN BANK ACT SYSTEM REFORMS

Subtitle A—Federal Home Loan Bank Act Amendments

SEC. 701. DEFINITIONS.

Subsections (a) and (b) make definitional adjustments to section 2(l) of the Federal Home Loan Bank Act to reflect the creation of the Federal Housing Finance Board and the replacement of the Federal Home Loan Bank Board with regard to duties relative to the supervision of the Federal home loan banks by the Federal Housing Finance Board. Section 2(l) is further amended such that the terms "Chairperson" and "Secretary" refer to the Chairperson of the Federal Housing Finance Board and the Secretary of Housing and Urban Development, respectively.

SEC. 702. FEDERAL HOUSING FINANCE BOARD ESTABLISHED.

The Federal Home Loan Bank Act is amended after section 2 to establish the Federal Housing Finance Board.

The Federal Housing Finance Board is established as an independent agency in the Executive branch of the Federal government to oversee and supervise the Federal Home Loan Banks. Subsections (b), (c) and (d) establish the composition of the seven member Board of Directors established to manage the Federal Housing Finance Board:

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

(a) The Secretary of Housing and Urban Development,

(b) Two Federal home loan bank presidents, to be elected by all Federal home loan bank presidents (2–year term), and

(c) Four Presidential Appointees (7–year term), two of whom shall be from organizations with a greater than 2–year history of representing consumer or community interests on banking, credit needs, housing and financial consumer protection.

The President of the United States shall designate one of the members of the Board of Directors to be Chairperson of the Board of Directors, who shall be the Chief Executive Officer of the Board. In the Chairperson's absence or disability, the duties of the Chairperson shall be performed by another member of the Board to be designated as Acting Chairperson by the Chairperson.

**84 In the event of a vacancy in the Office of the Secretary of Housing and Urban Development, or during the Secretary's absence or disability, the Acting Secretary shall serve as a member of the Federal Housing Finance Board in place of the Secretary.

Not more than two of the members of the Federal Housing Finance Board holding office under paragraph (c) shall be members of the same political party, and not more than one such member may be appointed from any single Federal home loan bank district.

In addition, members appointed under paragraph (c) may not (i) serve as a director or officer of any Federal home loan bank or member of such bank, and (ii) hold shares of, or any other financial interest in any member of any Federal home loan bank.

New section, "Section 2B. POWERS AND DUTIES; REPORT TO CONGRESS," grants the Federal Housing Finance Board the power to continue or establish collective offices or administrative units of the Federal home loan banks and, after consultation with the Federal home loan banks, appoint the heads of such offices and administrative units.

*175 The Federal Housing Board has the authority to fix the compensation of such employees, attorneys and agents of the collective offices or administrative units, without regard to provisions of laws applicable to officers or employees of the United States. Such collective offices and administrative units shall not constitute agencies of the United States for purposes of Title 5, United States Code.

The receipts of the Board derived from assessments upon the Federal home loan banks and from other sources other than receipts from the sale of consolidated obligations shall be deposited in the Treasury, and may be withdrawn to defray the expenses of the Board and pay the salaries of the employees of the Board.

Under subsection (e) the Comptroller General shall have (i) authority to audit the activities of the Federal Housing Finance Board and the Federal home loan banks, and (ii) shall perform annual financial audits of the Federal Housing Finance Board and report such findings to Congress. Furthermore, the Inspector General Act of 1978 is amended to reflect the creation of the Federal Housing Finance Board and its replacement of the Federal Home Loan Bank Board.

SEC. 703. TERMINATION OF THE FEDERAL HOME LOAN BANK BOARD AND THE POSITION OF CHAIRMAN OF THE FEDERAL HOME LOAN BANK BOARD.

Subsections (a) and (b) abolish the Federal Home Loan Bank Board and the position of the Chairman of the Federal Home Loan Bank Board, repealing section 17 of the Federal Home Loan Bank Act. The remaining subsections establish guidelines for the transfer of employees from the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation to the Federal Housing Finance Board, and protect the rights of such employees. The Federal Housing Finance Board and the director of the Office of Thrift Supervision shall jointly determine the functions and activities of and the number of employees of the Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corporation that perform such functions or activities shall transfer to new Federal Housing Finance Board. Employees holding permanent positions shall not be involuntarily separated or reduced in grade or compensation for 1 year after the date of transfer, except for cause, which must be communicated in writing in a timely fashion. In addition, employee benefit pro-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

grams are preserved.

**85 Subsection (b) shall not be construed as affecting the validity of any right, duty or obligation of the United States, the Federal Home Loan Bank Board or any other person which: arises under or pursuant to any section of title IV of the National Housing Act or under the Federal Home Loan Bank Act; and existed on the day before the date of enactment of this Act. No action or other proceeding commenced by or against the Federal Home Loan Bank Board, or any Federal Home loan bank with respect to any function of the Board which was delegated to the bank, shall abate by reason of the enactment of this Act, except that the appropriate successor to the interests of such Board or bank shall be substituted for such Board or bank as a party to any such action or proceeding.

*176 SEC. 704. LIMITATION ON LAWFUL CONTRACT RATE.

This section repeals section 5 of the Federal Home Loan Bank Act, which applies State usury rates for home mortgage loans to members of Federal home loan banks.

SEC. 705. RATE OF INTEREST ON DEPOSITS.

This section repeals section 5B of the Federal Home Loan Bank Act, which established ceiling on the rates to be paid on deposits.

SEC. 706. CAPITAL STOCK.

Section 706 removes outdated provisions relating to the minimum amount of capital stock that must be issued by a Federal home loan bank, the subscription by the United States for a portion of the capital stock of the Federal home loan banks and the subsequent retirement of the stock owned by the United States. The section further states that any time a member's membership in a Federal home loan bank is terminated (or the borrowing privileges of any nonmember is terminated), all advances must be repaid and a repayment fee would apply.

SEC. 707. ELECTION OF BANK DIRECTORS.

Section 7 of the Federal Home Loan Bank Act is amended such that at least two appointed directors of each Federal home loan bank must be representatives chosen from organizations with a greater than 2–year history of representing consumer or community interests on banking services, credit needs or housing and financial consumer protection. No member of the Board of Directors pursuant to this subsection shall, during such member's term of office, be an officer or director of any Federal home loan bank or a stock-holder, officer or director of any member of a Federal home loan bank.

SEC. 708. POWERS OF THE FEDERAL HOME LOAN BANK BOARD.

This section repeals section 19 of the Federal Home Loan Bank Act, which established certain powers of the Federal Home Loan Bank Board.

SEC. 709. POWERS AND DUTIES OF BANKS.

Section 709, by amending section 11 of the Federal Home Loan Bank Act, authorizes the Federal home loan banks to make loans to the Federal Deposit Insurance Corporation, subject to the concurrence of the Federal Housing Financing Board, for the use of the Savings Association Insurance Fund. Loans to the Federal Deposit Insurance Corporation shall be a direct liability on the insurance fund. The interest paid on these loans shall be not less than the current marginal cost of funds to that Federal home loan bank. Furthermore, loans are to be adequately secured, as determined by the Federal Housing Finance Board.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**86 Section 11 of the Federal Home Loan Bank Act is amended, to require each Federal home loan bank to establish a program to train officers and employees of member and nonmember borrowers in the underwriting of loans which benefit low and moderate income households and communities.

SEC. 710. RESERVES AND DIVIDENDS.

"SEC. 16. RESERVES AND DIVIDENDS." of the Federal Home Loan Bank Act is replaced to reflect the following provisions: Subsection*177 (a) allows each Federal home loan bank to carry to a reserve account portions of net earnings, against which losses may be charged, subject to the determination of the bank's Board of Directors. Subsection (b) certifies that a Federal home loan bank may charge these dividend payments against one or more of: (i) net earnings, (ii) undivided profits (as defined in section 21(d)(7) of the Federal Home Loan Bank Act), (iii) dividend stabilization reserves, and (iv) reserves set aside by such bank, prior to the effective date of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, which may be used to charge-off losses. Subsection (c) limits the amount of dividend payment to the extent that such payment would reduce aggregate capital below the sum of (i) paid-in capital, and (ii) the amount of reserves established in subsection (a). Subsection (d) certifies that this section is consistent with the obligation imposed on the Federal home loan banks under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 to make annual payments to the Resolution Funding Corporation.

SEC. 711. ADMINISTRATIVE EXPENSES.

Under subsection (a), section 18(b) of the Federal Home Loan Bank Act is amended. The Federal Housing Finance Board is granted the power to levy, semiannually upon the Federal home loan banks, an assessment sufficient to provide for the payment of Federal Housing Finance Board expenses. Subsection (b) amends section 18(c) of the Federal Home Loan Bank Act to reflect the creation of the Director of the Office of Thrift Supervision and the replacement of the Chairman of the Federal Home Loan Bank Board.

SEC. 712. NONADMINISTRATIVE EXPENSES; APPORTIONMENT.

This section repeals subsection (a) of section 18 and section 19(a) of the Federal Home Loan Bank Act relating to nonadministrative expenses and apportionment.

SEC. 713. FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION INDUSTRY ADVISORY COMMITTEE.

Section 715 abolishes the Federal Savings and Loan Insurance Corporation, by repealing section 21 of the Federal Home Loan Bank Act.

SEC. 714. ELIGIBILITY FOR MEMBERSHIP.

Section 4(a) of the Federal Home Loan Bank Act is amended such that Federal home loan bank membership is open to any federally insured depository institution; savings bank, insured bank as defined by the Federal Deposit Insurance Act or any insured credit union as defined by the Federal Credit Union Act, that demonstrate a commitment to housing.

SEC. 715. STUDY OF BANK TRANSFER OF JURISDICTION.

**87 Section 715, under subsection (a), requires the Secretary of the Treasury to conduct a study of the anticipated benefits of transferring institutions that are members of one Federal home loan bank from one district to another, with emphasis placed on the potential benefits of transferring savings and loans in Maryland from the 3rd District to the 4th Dis-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

trict. Subsection (b) requires the Secretary of the Treasury to take into consideration the importance of apportioning districts with due regard for the convenience and customary course of business of the eligible institutions in each district. *178 The Secretary of the Treasury shall report such findings, no later than 6 months after the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs.

SEC. 716. CONFORMING AMENDMENT.

Section 3 of Title I of P.L. 93–495 (an Act to increase deposit insurance) is amended to reflect the creation of the Director of the Office of Thrift Supervision and the replacement of the Federal Home Bank Board.

SEC. 717. ADVANCES.

Section 10(e) of the Federal Home Loan Bank Act is amended under subsection (a) to reflect the creation of the Federal Housing Finance Board and its replacement of the Federal Home Loan Bank Board. The subsection proceeds further to define the term "actual thrift investment percentage," which is given the same meaning as that in section 10(n)(5)(A) of the Home Owners Loan Act of 1933. Subsection (b) subsequently amends section (10) of the Federal Home Loan Bank Act by defining Community Support Requirements for Eligibility for Advances. Within 2 years of the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Federal Housing Finance Board shall adopt regulations establishing minimum standards of community investment or service for depository institution members to maintain continued access to advances.

Additionally, subsection (b) lays out the framework for the Community Investment Program and the Affordable Housing Program. Each Federal home loan bank shall designate a community investment officer who shall be responsible for implementing community lending and affordable housing advance programs.

A Community Investment Program shall be established by each Federal home loan bank and designed to provide funding for institutions to undertake community oriented lending for mortgages for which a secondary market does not exist. Advances shall be priced at the marginal cost of obligations, of comparable maturities, of the consolidated Federal Home Loan Banks.

In conjunction with the Community Investment Program, each Federal home loan bank shall establish an Affordable Housing Program for the purpose of subsidizing the interest rate on advances to members engaged in lending for long-term affordable low and moderate income housing at subsidized interest rates. Each Federal home loan bank shall annually contribute an amount equivalent to a percentage of its aggregate outstanding advances as of December 31 of the prior year to support loans through the Affordable Housing Program: (i) .05 percent of aggregate outstanding advances in 1990–1993 or such sum as required to assure that the contribution of all Federal home loan banks shall not be less than $75 million for each of the 4 years, (ii) .06 percent of aggregate outstanding advances for 1994 or such sum as required to assure that the aggregate contribution of the Federal home loan banks shall not be less than $90 million for that year, (iii) 0.1 percent of aggregate outstanding advances for 1995 and subsequent years or such sums as required to assure that the aggregate contribution of all Federal *179 home loan banks shall not be less than $150 million for each of those years.

**88 Each Federal home loan bank shall give priority to qualified projects such as: (i) the purchase, rehabilitation, or construction of multifamily rental housing, (ii) the purchase or rehabilitation of housing held by the U.S. government or agency, and (iii) housing sponsored by any nonprofit organization, State, housing authority or State housing finance agency.

If a Federal home loan bank does not utilize or commit the full amount provided to the Affordable Housing Program in any year, the excess above 10 percent of the full amount that should have been utilized or committed in that year shall be placed in an Affordable Housing Reserve Fund administered by the Federal Housing Finance Board. Any unutilized or

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

uncommitted funds retained by a Federal home loan bank must be fully utilized or committed by that Federal home loan bank during the following year, and any remaining portion must be placed in the Affordable Housing Reserve Fund. Funds from the Affordable Housing Reserve Fund may be made available to any bank to meet additional affordable housing needs in such bank's district.

An institution will be eligible for access to advances in connection with the Community Investment Program and the Affordable Housing Program to be established by each Federal home loan bank, regardless of such institution's ability to achieve or maintain the qualified thrift lender standard.

Advisory Council—Each Federal Home Loan Bank shall appoint an Advisory council of 7 to 15 persons from community and non-profit organizations involved in promoting low and moderate income housing in its district. The Council shall meet with the Board of Directors of the bank quarterly to advise the Directors on low and moderate income housing needs in the district.

Reports To Congress—The Federal Housing Finance Board shall monitor and report to the Congress and the Advisory Council for each Federal home loan bank annually on the support of low income housing and community development by the banks and the utilization of advances for these purposes. In addition to the programs described above, the subsection provides definitions describing the terms "Low or Moderate Income Household," "Low or Moderate Income Neighborhood," and "Affordable Rental Housing."

Subsection (c) reaffirms that the Federal home loan banks are a source of needed short-term liquidity for solvent member institutions. Section 10 of the Federal Home Loan Bank Act is amended to add a new subsection (g) "BANKS ARE SOURCE OF NEEDED LIQUIDITY FOR MEMBERS." The Federal home loan banks shall continue to provide needed short-term liquidity to all solvent members including those certified "supervisory concern", but which have a reasonable prospect of recovery. Short-term liquidity shall be provided at terms no less favorable than those regularly made to institutions not considered to be a supervisory concern. In addition, the Federal Housing Finance Board shall, upon the certification of the Director of the Office of Thrift Supervision that severe financial conditions exist in any community or region that threaten the stability of a significant number of savings associations in that community or region, consult with the Director of the Office of ***180** Thrift Supervision to establish credit policies, procedures and standards that shall maximize the availability of advances to savings associations consistent with principles of prudent lending, including collateral requirements and interest rates, and the public interest.

SEC. 718. AMENDMENTS RELATING TO WITHDRAWALS FROM FEDERAL HOME LOAN BANK MEMBERSHIP.

****89** Section 6(m) of the Federal Home Loan Bank Act is amended such that an institution would be required to wait 10 years, instead of the current 5–year suspension, before being eligible for Federal home loan bank membership.

SEC. 719. TECHNICAL AND CONFORMING AMENDMENTS.

This section contains provisions making miscellaneous conforming amendments to the Federal Home Loan Bank Act or other laws relating to the former Federal Home Loan Bank Board or Federal Savings and Loan Insurance Corporation.

Subtitle B—Conforming Amendments

SEC. 721. FEDERAL HOME LOAN MORTGAGE CORPORATION.

Section 721(a)(1 & 2) subsection (a) amends Section 301 of the Federal Home Loan Mortgage Corporation Act to provide that the purposes of the Federal Home Loan Mortgage Corporation are to provide stability in the secondary market for home mortgages, to respond appropriately to the private capital market and to provide ongoing assistance to the secondary market for home mortgages (including mortgages securing housing for low and moderate income families in-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

volving a reasonable economic return to the Corporation) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for home mortgage financing.

Section 721(b)(1) establishes the Federal Home Loan Mortgage Corporation, which shall be a corporate body under the direction of a Board of Directors. The Board of Directors shall determine general policies that govern operations of the Corporation and the principal office of the Corporation shall be in the District of Columbia or at any place determined by the Corporation.

The subsection requires that the Board of Directors shall consist of 18 persons, 5 of whom shall be appointed annually by the United States President and the remainder of whom shall be elected annually by the voting common stockholders. The Board of Directors shall at all times have as members appointed by the President at least 1 person from the home building industry, at least 1 person from the mortgage lending industry, and at least 1 person from the real estate industry.

Each member of the Board of Directors shall be appointed or elected for a term ending on the date of the next annual meeting of the voting common stockholders, except that any such member may be removed from office by the President for good cause.

The President shall fill by appointment any appropriate seat on the Board of Directors that becomes vacant, but only for the unexpired portion of the term. The Board of Directors shall fill any elective seat on the Board of Directors that becomes vacant after the ***181** annual election of the directors, but only for the unexpired portion of the term.

Any member of the Board of Directors who is a full-time officer or employee of the Federal government shall not, as such member, receive compensation for services as a member.

Section 721(b)(2)(A)(i) establishes an interim Board of Directors of the Federal Home Loan Mortgage Corporation, which shall serve from the date of enactment of the 1989 Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) until the date of the first meeting of the voting common shareholders of the Corporation at which the first election of the Directors elected by the shareholders occurs. The interim Board of Directors of the Federal Home Loan Mortgage Corporation shall consist of the Corporation President and the persons who were (on the day prior to the date of the FIRREA enactment) the Chairman of the Federal Home Loan Bank Board and the HUD Secretary (or their designees). A quorum of the interim Board of Directors of the Federal Home Loan Mortgage Corporation shall consist of a majority of the Directors.

****90** The first meeting of the voting common shareholders of the Federal Home Loan Mortgage Corporation for election of Directors shall occur within 6 months following the date of enactment of FIRREA under procedures established by the Corporation.

Section 721(c) provides the HUD Secretary with general regulatory power over the Corporation and the power to make such rules and regulations as shall be necessary and proper. The HUD Secretary will have the discretion to require that a reasonable portion of the mortgage purchases of the Corporation be related to the national goal of providing adequate housing for low and moderate income families, but with reasonable economic return to the Corporation.

The aggregate amount of cash dividends paid by the Corporation in any fiscal year on account of any share of its common stock shall not exceed any rate that may be determined from time to time by the HUD Secretary to be a fair rate of return, after consideration of the current earnings and capital condition of the Corporation.

The HUD Secretary has the discretion to examine and audit the books and financial transactions of the Corporation and to require the Corporation to issue any reports on its activities that the Secretary determines to be advisable. The Secretary must submit to Congress a report describing the activities of the Corporation not later than June 30 of each year.

The aggregate amount of notes, debentures, or substantially identical types of unsecured obligations outstanding at any time shall not exceed the amount which is 15 times the sum of the Corporation's capital, capital surplus, general surplus, reserves, and undistributed earnings unless a greater ratio shall be fixed at any time or from time to time by the HUD Secretary. The capital of the Corporation, for the purpose of determining the aggregate amount of notes, debentures or substantially identical types of unsecured obligations outstanding at any time, is defined as the outstanding total principal

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

amount of any obligations of the Corporation which are entirely subordinated to the general debt obligation of the Corporation.

*182 All stock issuances and debt obligations convertible into stock by the Corporation shall be made only with the approval of the HUD Secretary. In addition, the approval of the HUD Secretary is necessary for the Corporation to exercise authority to purchase, service, sell, lend on the security of, or otherwise deal in conventional residential mortgages.

The HUD Secretary will be deemed to have approved any conventional mortgage programs or activities regarding purchasing, servicing, selling, lending on the security of, or otherwise dealing in mortgages in which the Corporation has engaged or is engaging as of the date of enactment of the FIRREA.

The HUD Secretary is required to approve a request for approval or other action from the Corporation, not later than the expiration of the 45–day period following the submission of the request. The period may be extended for an additional 15–day period if the Secretary requests additional information from the Corporation, but the 45–day period may not be extended for any other reason or for any period in addition to or other than the 15–day period. The Corporation may proceed as if the request had been approved if the Secretary fails to transmit the report to Congress within the 45–day period or 60–day period.

**91 Section 721(d)(1) requires that the common stock of the Corporation shall consist of nonvoting common stock, which shall be issued only to Federal home loan banks and voting common stock, which shall be issued to such holders in the manner and amount, and subject to any limitations on concentration of ownership the Corporation may establish.

Nonvoting common stock and voting common stock shall have such par value and other characteristics as the Corporation provides and voting common stock shall be vested with all voting rights, each share being entitled to 1 vote. The free transferability of the voting common stock at all times to any person, firm, corporation or other entity shall not be restricted, an exception being that the voting common stock shall be transferable only on the books of the Corporation. Nonvoting common stock of the Corporation shall be evidenced in the manner and shall be transferable only to the extent provided by the Corporation.

Section 721(d)(2) requires that each share of outstanding senior participating preferred stock of the Federal Home Loan Mortgage Corporation, with a par value of $2.50 per share, shall be changed into and shall become 1 share of voting common stock of the Corporation. Such voting common stock shall, with respect to the nonvoting common stock of the Corporation, retain all of the rights, priorities and privileges of the senior participant preferred stock. The transformation of the senior participating preferred stock into voting common stock shall be deemed to satisfy the obligation of the Corporation to redeem senior participating preferred stock for non-callable common stock. Section 721(d)(3) provides conforming amendments so that present restrictions on common stock held by the Federal Home Loan Banks are maintained.

Section 721(e) authorizes the Corporation to lend on the security of, and to make commitments to lend on the security of, any mortgage that the Corporation is authorized to purchase. The volume of the Corporation's lending activities and the establishment of its *183 loan ratios, interest rates, maturities, and charges of fees in its secondary market operations should be determined by the Corporation from time to time in a manner consistent with the objectives that the lending activities should be conducted on such terms as will reasonably prevent excessive use of the Corporation's facilities, and that the operations of the Corporation would be within its income derived from those operations and that such operations should be fully self-supporting. The Corporation is prevented from suing its lending authority: (A) to advance funds to a mortgage seller on an interim basis, using mortgage loans as collateral, pending the sale of mortgages in the secondary market or (B) to originate mortgage loans. The Corporation, in connection with any loan whether before or after any default, is authorized to provide by contract with the borrower for the settlement or extinguishment upon default, of any redemption, equitable, legal, or other right, title, or interest of the borrower in any mortgage or mortgages that constitute the security for the loan. The mortgages that constitute the security shall become the Corporation's absolute property, in the event of default and pursuant otherwise to the terms of the contract.

**92 Section 721(f) provides technical conforming amendments to reflect that the Resolution Trust Corporation is taking over certain powers of the FSLIC and that the Federal Housing Finance Board replaces the Federal Home Loan Bank

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Board.

Section 721(g) allows the Treasury Secretary to purchase any obligations issued. The Secretary has the discretion to use as a public debt transaction the proceeds of the sale of any securities issued. The Secretary shall not at any time purchase any obligations if the purchase would increase the aggregate principal amount of the outstanding holdings of obligations by the Secretary to an amount greater than $2.250 billion and provides that such purchases may be made only to such extent or in such amounts as are appropriated.

Section 721(h) requires that each purchase of obligations by the Treasury Secretary shall be upon terms and conditions established to yield a rate of return determined by the Secretary to be appropriate, taking into consideration the current average rate of outstanding marketable obligations of the U.S. as of the last day of the month preceding the making of the purchase. The Secretary is allowed to sell at any time any of the obligations acquired by the Secretary, upon terms and conditions and at prices determined by the Secretary. All redemptions, purchases and sales by the Secretary of obligations are required to be treated as public debt transactions of the U.S.

Any notes, debentures, or substantially identical types of unsecured obligations of the Corporation evidencing money borrowed, whether general or subordinated, shall be issued upon the approval of the Treasury Secretary and shall have such maturities and bear such rate or rates of interest as may be determined by the Corporation with the approval of the Secretary. Any notes, debentures, or substantially identical types of unsecured obligations of the Corporation having maturities of 1 year or less that the Corporation has issued or is issuing as of the date of the enactment of FIRREA shall be deemed to have been approved by the Secretary. Such deemed approval shall expire 365 days after the date of the enactment*184 of FIRREA. Any notes, debentures, or substantially identical types of unsecured obligations of the Corporation having maturities of more than 1 year that the Corporation has issued or is issuing as of the date of the enactment of FIRREA shall be deemed to have been approved by the Secretary. Such deemed approval shall expire 60 days after the date of the enactment of FIRREA.

Any securities in the form of debt obligations or trust certificates of beneficial interest, or both, and based upon mortgages held and set aside by the Corporation, shall be issued upon the approval of the Secretary and shall have such maturities and shall bear such rate or rates of interest as may be determined by the Corporation with the approval of the Secretary. Any securities in the form of debt obligations or trust certificates of beneficial interest, or both, and based upon mortgages held and set aside by the Corporation, that the Corporation has issued or is issuing as of the date of the enactment of FIRREA shall be deemed to have been approved by the Secretary.

**93 Section 721(i)(1) establishes the purposes of the Federal National Mortgage Association to be: (1) providing stability in the secondary market for home mortgages; (2) responding appropriately to the private capital market; and (3) providing ongoing assistance to the secondary market for home mortgages (which includes mortgages securing housing for low and moderate income families involving a reasonable economic return) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for home mortgage financing.

Section 721(i)(2) prohibits the Corporation from using its lending authority (A) to advance funds to a mortgage seller on an interim basis, using mortgage loans as collateral, pending the sale of the mortgages in the secondary market or (B) to originate mortgage loans.

Section 721(i)(3) requires that the financial transactions of the Corporation shall be subject to audit by the Comptroller General of the U.S. according to commercial corporation transaction principles and procedures under rules and regulations that the Comptroller General may issue. Representatives of the General Accounting Office (GAO) shall have access to all books, accounts, financial records, reports, files, and all other papers, things, or property belonging to or in use by the Corporation and necessary to facilitate the audit, and that said representatives shall be afforded full facilities for verifying transactions with the balances or securities held by depositories, fiscal agents, and custodians. The Comptroller General shall report on each such audit to the Congress. The Corporation shall reimburse GAO for the full cost of any such audit as billed therefor by the Comptroller General.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC. 722. REPEAL OF LIMITATIONS OF OBLIGATION FOR ADMINISTRATIVE EXPENSES.

Section 722 deletes the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation and the Home Owner's Loan Corporation (once a component of the Federal Home Loan Bank Board, which was dissolved in 1951) from the First Deficiency Appropriation Act of 1936.

*185 SEC. 723. AMENDMENT OF TITLE 5, UNITED STATES CODE.

Section 5134 of Title 5, United States Code is amended to reflect the creation of the Federal Housing Finance Board, the Office of Thrift Supervision and the termination of the Federal Home Loan Bank Board.

SEC. 724. AMENDMENT OF BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT PROVISIONS.

Technical changes are made to the Balanced Budget and Emergency Deficit Control Act of 1985 to reflect the creation of the Federal Housing Finance Board and its replacement of the Federal Home Loan Bank Board.

SEC. 725. STUDY REGARDING CAPITAL REQUIREMENTS FOR GOVERNMENT SPONSORED ENTERPRISES.

Subsections (a) and (b) outline the criteria for a study to be conducted by the Comptroller General of the United States regarding capital requirements for government sponsored enterprises.

**94 Section 725(a) requires the Comptroller General to conduct a study of the risks undertaken by and the appropriate level of capital consistent with: 1) the financial soundness and stability of the government-sponsored enterprises and 2) minimizing any potential financial exposure of the Federal government. A study must be conducted in consultation and cooperation with the government-sponsored enterprises.

Section 725(b) requires that the study shall examine and evaluate: 1) the type of risks that are undertaken by the government-sponsored enterprises in the course of their operations; 2) the appropriateness of applying a risk-based capital standard, which includes at a minimum both an interest rate risk component and a credit risk component, to each of the government-sponsored enterprises, taking into account the nature of the business each government-sponsored enterprise conducts; 3) the costs and benefits to the public from application of a risk-based capital standard to the government-sponsored enterprises and the impact of such a standard on the capability of each government-sponsored enterprise to carry out its statutory mission; and 4) the categories of risks and the overall level of capital appropriate for the government-sponsored enterprises.

Section 725(c) requires that the Comptroller General submit not later than May 1, 1990, to the Congress a report setting forth: 1) the results of the study conducted under this section; and 2) any recommendations of the Comptroller General with respect to appropriate capital standards for each government-sponsored enterprise.

Section 725(d) defines the term "government-sponsored enterprises" to mean the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Federal Farm Credit System, the Federal Agricultural Mortgage Corporation, the College Construction Loan Insurance Corporation, the Student Loan Marketing Association, the Resolution Trust Corporation, and the Resolution Finance Corporation.

*186 TITLE VIII—BANK CONSERVATION ACT AMENDMENTS

SEC. 801. DEFINITIONS.

Section 801 amends section 202 of the Act of March 9, 1933, title II of which is the Bank Conservation Act ("Act"). The amendment defines the term "bank" to include federally-chartered financial institutions, other than national banks, that are supervised by the Comptroller (hereinafter referred to as "bank").

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC. 802. APPOINTMENT OF CONSERVATOR.

Section 802 amends section 203 of the Act to give the Comptroller exclusive authority to appoint either the FDIC or another person as conservator for a bank and sets out a number of conditions under which the Comptroller may make such an appointment. This section also permits an affected bank to bring an action within 10 days of the appointment. The action would be in the nature of an injunction to terminate the Comptroller's decision to appoint a conservator. The Comptroller's decision to appoint a conservator shall be set aside only if the court finds that the decision was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. Any other judicial action pending against the bank would be stayed until the conservatorship matter is resolved. Except as provided in this section, no court may affect by injunction or otherwise the appointment of a conservator or take other actions with respect to such conservatorship except for enforcement orders at the request of the Comptroller.

SEC. 803. EXAMINATIONS.

**95 Section 803 amends section 204 of the Act by deleting the existing section and by replacing it with a new section 204. The new section requires the Comptroller to consult with the FDIC when examining and supervising an ongoing bank for which the FDIC has been appointed conservator.

SEC. 804. TERMINATION OF CONSERVATORSHIP.

This section amends section 205 of the Act regarding the termination of the conservatorship. The conservatorship may be terminated as the result of a sale, merger or consolidation of the bank, or by the bank being placed in receivership by a declaration of insolvency, or by the bank being permitted to resume its business in the same form as previously, although most likely under new management or directorate. When the FDIC has been appointed conservator, the Comptroller must seek the approval of the FDIC to terminate the conservatorship. The FDIC would wind up the affairs of such a conservatorship. If the bank is sold, provision is made for an interpleader action whereby shareholders and nondepositor claimants may request that the district court equitably distribute the net proceeds of such sale.

SEC. 805. CONSERVATOR; POWERS AND DUTIES.

Section 805 replaces the existing provisions of section 206 of the Act with provisions that specify, in general terms, the powers and responsibilities of the conservator. The current Act does not establish with sufficient clarity that the conservator has the full range of powers possessed by bank management. Section 805 resolves this situation by stating that the conservator will be given the authority*187 and responsibility of the shareholders, officers and board of directors. This section also provides that the conservator, except to the extent waived or modified by the Comptroller, shall be subject to the laws applicable to officers, directors and employees of a national bank and authorizes the Comptroller to pay the conservator at rates in excess of rates paid to federal employees performing similar work in certain situations. However, the Comptroller will be able to authorize payments at higher rates if such higher rates are necessary to recruit competent personnel from outside the agency to act as conservators as the need arises by allowing the Comptroller to compensate such individuals in a manner commensurate with similar positions in private industry.

SEC. 806. LIABILITY PROTECTION.

Section 806 replaces the existing provisions of section 209 of the Act. This section provides that the conservator shall not be held liable for damages in tort or otherwise, except for gross negligence, for acts or omissions performed in the course of the conservator's duties. In addition, new section 209(b) adds a provision that will allow the Comptroller to indemnify the conservator.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC. 807. RULES AND REGULATIONS.

Section 807 amends section 211 of the Act. Section 211 authorizes the Comptroller to prescribe regulations necessary to carry out this act.

SEC. 808. REPEALS.

**96 Section 808 repeals section 207 (reorganization; consent of depositors and creditors) and section 208 (provisions as to segregation of deposits inapplicable after termination of conservatorship, notice of termination) of the Act.

SEC. 809. CONFORMING AMENDMENT.

Section 809 would add conservators appointed under 12 U.S.C. 203 to the list of persons that may be appointed by the Comptroller of the Currency without regard to the otherwise applicable limitation contained in 5 U.S.C. 5373 (which generally prohibits an agency head from fixing the compensation of a position or employee at no more than the maximum rate for GS–18).

TITLE IX—REGULATORY ENFORCEMENT AUTHORITY AND CRIMINAL ENHANCEMENTS

Subtitle A—Expanded Enforcement Powers, Increased Penalties, and Improved Accountability

SEC. 901. EMPLOYEES, AGENTS, AND SHAREHOLDERS OF A FINANCIAL INSTITUTION SUBJECT TO ADMINISTRATIVE ENFORCEMENT ORDERS AND SUBSTITUTION OF "FINANCIAL INSTITUTION" FOR BANK IN ENFORCEMENT PROVISIONS.

This section expands the reach of the banking agencies' civil enforcement authority, by defining the term "persons participating in the conduct of the affairs" of a financial institution (a phrase found throughout the enforcement provisions). This section specifies that this terminology may include (a) employees, agents, consultants, and shareholders, (b) parties proposing a change in control, (c) independent contractors, such as appraisers, attorneys, and accountants *188 (who are not otherwise employees or insiders covered within category (a)), and (d) such other persons as the agencies may prescribe by regulations. This section limits the exposure of independent contractors to those persons who knowingly or with reckless disregard participate in a violation of law or engage in an unsafe or unsound practice, which caused or is likely to cause a loss or other adverse effect. It also makes necessary technical changes.

SEC. 902. AMENDMENTS TO CEASE AND DESIST AUTHORITY WITH RESPECT TO RESTITUTION, RESTRICTIONS ON SPECIFIC ACTIVITIES, AND INCOMPLETE OR INACCURATE RECORDS.

This provision amends the banking agencies' cease and desist ("C & D") authority in several ways. First, it clarifies the agencies' authority to issue an order requiring persons and institutions to take affirmative action to correct certain conditions. Such corrective action may include mandated disposition of loans or assets, restrictions on growth, or rescission of agreements or contracts. The agencies would be empowered to order restitution or reimbursement in a C & D order, but only to recover for those losses resulting from serious misconduct. Second, this section specifies that C & D orders may include restrictions on specific activities of the institution or its employees (such as restricting an individual's lending authority over certain dollar amounts). Third, an agency would possess authority to issue temporary corrective C & D orders whenever an institution's records are so incomplete or inaccurate that the regulatory agency is not able to determine the institution's financial condition.

SEC. 903. MERGER OF REMOVAL AND PROHIBITION AUTHORITY.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**97 First, under present law, agencies follow different standards for removal actions, depending on where the misconduct took place, whether at another financial institution or business enterprise, or at the particular institution from which removal is sought. This section unifies the two separate removal provisions in Sections 8(e)(1) and (2) of the Federal Deposit Insurance Act ("FDI Act") and in Sections 206(g)(1) and (2) of the Federal Credit Union Act, thereby making the legal grounds for enforcement action the same, irrespective of where the serious misconduct occurred. Second, this section would allow an agency to proceed with removal or prohibition action, where warranted, without having to quantify losses to the institution or the degree of prejudice to the depositors ("substantial" losses or "serious prejudice" are now required as proof under present law). Third, this section expands the grounds for removal/prohibition actions, to include (a) violations of (1) written agreements between financial institutions and regulatory agencies, (2) any condition imposed in writing by the banking agency in connection with a grant or any application or other request by the institution, (3) relevant laws or regulations, or (4) cease and desist orders and (5) unsafe or unsound practices or breaches of fiduciary duty. In addition, a banking agency will have to prove some scienter by the culpable individual and also financial gain to the perpetrator or financial loss to, or other adverse impact on, the institution. The amendments in this section apply to violations committed and activities engaged in after the date of enactment of this Act.

*189 SEC. 904. INDUSTRYWIDE APPLICATION OF REMOVAL, SUSPENSION, AND PROHIBITION ORDERS.

Under this section any officer, director or person participating in the conduct of the affairs of an institution who is removed or suspended from an institution or prohibited from active participation, would be automatically barred by statute from holding office, employment, and further participation in all other insured financial institutions and financial institution holding companies (and subsidiaries), and also from employment by any of the banking agencies, while the original order is in effect. The affected individual could seek the prior written approval of the appropriate Federal banking agency overseeing the financial institution where the person plans to work, for example, to obtain a special exception. The agency considering approval would have to consult with the agency issuing the order.

SEC. 905. ENFORCEMENT PROCEEDINGS ALLOWED AFTER SEPARATION FROM SERVICE.

This section explicitly authorizes the banking agencies to take enforcement actions, including prohibition orders and civil money penalties ("CMPs"), against culpable insiders who resign or otherwise depart from an institution within 5 years after they leave the institution. It does not matter whether the separations from service were voluntary or involuntary, and therefore this provision covers departures caused by the closing of the financial institution. This provision does not create a new offense, but clarifies when the banking agencies may initiate enforcement actions against individuals. Therefore, this provision would cover a number of matters which have been informally pending, awaiting resolution of this issue by the Congress.

SEC. 906. EXPANSION OF REMOVAL POWERS FOR STATE CRIMINAL PROCEEDINGS.

**98 At present, indictment by a Federal grand jury or formal charges by a U.S. Attorney for crimes involving dishonesty or breach of trust are grounds for a temporary suspension of an individual. After conviction, a banking agency can now remove the individual through administrative proceedings. This section would expand this provision to include similar State criminal charges and convictions. It would also expand Federal banking agency removal powers to include pleas of nolo contendere and pretrial diversion programs, in addition to final convictions.

SEC. 907. AMENDMENTS TO EXPAND AND INCREASE CIVIL MONEY PENALTIES.

This section increases the maximum amount of civil money penalties, authorized in title 12 of the United States Code, and expands the grounds for imposing them.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

There would be several major changes to existing law. First, section 907 reorganizes the civil money penalty provisions to make them more understandable. Second, it expands the grounds for CMPs, now limited only to C & D order violations, to include violations of (a) any written agreements between the agency and a financial institution, (b) any removal or prohibition orders (in addition to C & D orders), (c) any law or regulation, and (d) conditions imposed in writing in connection with a request. Third, the amendment*190 increases the $1,000 or $100 CMPs found throughout the banking statutes to $15,000, per day or per violation. It applies a much higher (per day or per violation) maximum penalty for individuals of $1 million and for institutions of $1 million or 1% of assets (whichever is less) for the following misconduct: knowing violations of law or regulations; knowing unsafe or unsound practices; or, knowing breaches of fiduciary duty, any of which result in substantial loss to the financial institution or a substantial gain to the guilty party. Fourth, the scope of judicial review upon appeal is expanded to include all grounds in the Administrative Procedure Act (5 U.S.C. 706). Fifth, all penalty recoveries would go to the banking agencies, not to the Treasury, to defray enforcement expenses.

The amendment also increases the criminal penalties for serious violations of laws governing savings and loan holding companies and the Bank Holding Company Act, by establishing felony penalties for knowing violations with specific intent, to deceive, to defraud, or to profit significantly. Misdemeanor penalties for knowing violations done without a specific intent are retained.

The amendments in this section would apply to those violations committed and activities engaged in after the date of the enactment of this Act, except the increased $15,000 penalty may apply to such violations or activities occurring prior to this date, if they were not already the subject of a pending proceeding and they occurred after the last completed examination.

SEC. 908. CLARIFICATION OF CRIMINAL PENALTY PROVISIONS FOR VIOLATION OF CERTAIN ORDERS.

**99 Current law makes it a misdemeanor for a person subject to a suspension, removal or prohibition order to participate in the affairs of an institution, without the prior approval of the appropriate Federal banking agency. This section extends this provision to include participation in bank holding companies and savings and loan holding companies and certain other organizations, and also increases the maximum criminal penalties to a $1 million fine or up to 5 years imprisonment.

SEC. 909. SUPERVISORY RECORDS.

This section would require Federal banking agencies to make available to the FDIC, in its capacity as a receiver of closed financial institutions, all supervisory records pertaining to that institution.

SEC. 910. INCREASED PENALTY FOR PARTICIPATION BY CONVICTED INDIVIDUALS.

This section amends provisions of current law imposing civil money penalties on institutions which wilfully employ individuals convicted of a crime involving dishonesty or breach of trust, without prior approval of the appropriate banking agency. First, "persons participating in the conduct of the affairs of" an institution would now be covered under the statute. Second, the section replaces "wilful" with "knowing", as the level of requisite intent. Third, it applies the penalty to both financial institutions which and individuals who knowingly violate the statute. Fourth, it establishes a maximum criminal penalty of five years imprisonment or $1 million per day in fines.

*191 SEC. 911. AMENDMENTS TO VARIOUS PROVISIONS OF LAW RELATING TO REPORTS.

Subsection (a) amends the Bank Protection Act of 1968, to delete the requirement that banks and thrift institutions submit periodic reports concerning the installation, maintenance and operations of security devices and procedures.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Subsections (b) through (h) give the banking agencies more discretion to determine when institutions must submit reports of condition. These subsections also confer on the agencies CMP authority for (1) failures to file or the late filing of call reports and other information and also (2) filing any false or misleading reports or information. The maximum CMP would be $15,000 per day, except that violations made with knowing or reckless disregard for the accuracy of the information in the report may give rise to a maximum penalty of $1 million or 1% of assets, whichever is less.

The amendments require the agencies to follow existing administrative procedures which provide an opportunity to challenge such assessments and to present all mitigating and aggravating circumstances surrounding such violations, including the good faith of the institution, the gravity of the violation, and the history of previous violations.

SEC. 912. AUTHORITY OF THE FDIC TO TAKE ENFORCEMENT ACTION AGAINST SAVINGS ASSOCIATIONS.

The Board of Directors of the FDIC may request the Office of Thrift Supervision ("OTS") to take particular enforcement action concerning any savings association. If the OTS did not take such recommended action within 60 days, the Board of Directors could initiate enforcement proceedings, unless exigent circumstances required a shorter time period. Such actions could not be delegated by the FDIC Board of Directors.

**100 Additionally, the provision requires (a) the Federal home loan banks to submit all requests for formal investigations or enforcement actions to the FDIC at the same time they are submitted to the OTS and (b) the OTS to provide quarterly reports to the FDIC on the status of such requests and also the status of all ongoing investigations and enforcement proceedings.

SEC. 913. PUBLIC DISCLOSURE OF ENFORCEMENT ACTIONS REQUIRED.

This section requires the banking agencies to publicly disclose final enforcement orders and any modifications or terminations of such orders. Such publication could be reasonably delayed if public disclosure would seriously threaten the safety or soundness of a particular insured institution. Informal supervisory orders would not have to be disclosed.

SEC. 914. AGENCY DISAPPROVAL OF DIRECTORS AND SENIOR EXECUTIVE OFFICERS OF CERTAIN FINANCIAL INSTITUTIONS.

Troubled financial institutions (and their holding companies), newly chartered institutions (within 2 years), and those which had undergone a change in control (also within 2 years) would have to give 30 days notice to their bank regulatory agencies before appointing senior executive officers or directors. The banking agencies would then be able to disapprove within this 30 day period such appointments. An agency's decision not to disapprove such an individual would not later prejudice the agency's ability to take enforcement*192 action (including removal action), if such were warranted.

The agencies are to define "troubled" and "senior executive officers" and prescribe by regulation those extraordinary circumstances under which the prior notice requirement could be waived, allowing directors to be appointed or senior management to be employed quickly because of such circumstances. The agencies would still have 30 days to disapprove this addition or employment.

SEC. 915. CLARIFICATION OF NCUA'S AUTHORITY TO CONDUCT COMPLIANCE INVESTIGATIONS.

These amendments clarify the NCUA's authority to monitor and investigate instances where the NCUA suspects noncompliance with its statute or regulations, during or outside of the normal examination process. They also clarify the NCUA's authority to conduct investigations to determine appropriate claims on insured accounts. The changes are consistent with similar authority possessed by the FDIC and the Office of Thrift Supervision.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC. 916. CONTINUITY OF AUTHORITY FOR ONGOING LITIGATION.

This is a grandfather provision that allows the Office of Thrift Supervision to pursue any ongoing litigation conducted by the Federal Home Loan Bank Board or the FSLIC.

SEC. 917. EXTENSION OF AUTHORITY.

This section allows any ongoing Bank Board administrative proceedings to continue under the new system and keeps in force all current prohibition orders previously issued by the Bank Board.

SEC. 918. IMPROVED ADMINISTRATIVE HEARINGS AND PROCEDURES.

This provision would require the Federal banking agencies to jointly establish their own pool of administrative law judges and to develop a set of uniform rules and procedures to improve and expedite administrative hearings. It reflects recent recommendations of the Administrative Conference of the United States and the House Government Operations Committee.

SEC. 919. TASK FORCE STUDY OF DELEGATION OF ENFORCEMENT ACTIONS.

**101 This provision mandates an interagency task force study of the desirability and feasibility of additional delegation of investigation and enforcement authority to banking agency regional offices or district banks (which will have representatives on the task force) to improve the timeliness and effectiveness of the enforcement process, including identifying areas where additional delegation would be feasible and helpful. The task force's study and the responses of the heads of the banking agencies must be reported to Congress by September 30, 1990.

SEC. 920. IMMUNITY OF AGENCY EMPLOYEES.

This section would grant to banking agency officials and employees a specific immunity from civil lawsuits in State or Federal court. This immunity would apply to all transmittals of criminal referral information to law enforcement agencies and other information to State or Federal banking agencies. This provision does not change or in any way impair any preexisting immunities under the Federal Tort Claims Act and other statutes available to Government employees in the exercise of official duties.

*193 SEC. 921. ANNUAL REPORT TO CONGRESS.

This provision would require the banking agencies to submit annual enforcement reports to Congress showing (a) numbers of enforcement and supervisory actions, (b) data on uncollected CMPs, (c) a description of other enforcement efforts and initiatives, and (d) recommendations concerning additional legislation and resources.

Subtitle B—Termination of Deposit Insurance

SEC. 926. REVISION OF PROCEDURES FOR TERMINATION OF FDIC INSURANCE.

This provision reorganizes subsection (8)(a) of the Federal Deposit Insurance Act but utilizes most of the same language now in the statute. It abolishes the requirement that the FDIC give the primary regulatory agency (the OCC, the Director, the State authorities, or the Federal Reserve Board) 120 days notice prior to terminating insurance. This section creates a new subsection, allowing for temporary suspension of insurance whenever a bank has no common or perpetual noncumulative preferred equity capital (or the equivalent for mutual institutions) or a savings association has no risk-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

adjusted capital and no core capital.

Subtitle C—Improving Early Detection of Misconduct and Encouraging Informants

SEC. 931. INFORMATION REQUIRED TO BE MADE AVAILABLE TO OUTSIDE AUDITORS.

This section mandates that all federally-insured financial institutions directly furnish to their external auditors copies of their most recent call reports, examination reports (both State and Federal), and all ongoing and final civil enforcement or other supervisory actions.

SEC. 932. FINANCIAL INSTITUTION EMPLOYEE PROTECTION REMEDY.

This section creates a new cause of action for financial institution employees who are fired because they provide information to a banking agency or to the Justice Department concerning a possible violation of law or regulation. The section contains a one year limitations period, and it empowers a district court to order reinstatement, compensatory damages, or other appropriate remedies, if the employee was wrongfully discharged. Persons who caused the misconduct or who knowingly or recklessly provided false information would not be able to pursue such actions. Also, this section allows courts to award attorneys' fees to defendants for lawsuits brought in bad faith.

SEC. 933. REWARD FOR INFORMATION LEADING TO RECOVERIES OR CIVIL PENALTIES.

**102 Within its discretion, a banking agency could pay a reward to a person providing "original" information which leads to a recovery of a criminal fine, restitution, a civil penalty under the banking statutes or under one of the applicable criminal provisions, or a forfeiture, if the amount or recovery exceeds $50,000. The maximum reward cannot exceed the lesser of 25 per cent of the fine, penalty, restitution, or forfeiture or $100,000. Government employees are ineligible for the rewards, as are persons who caused or *194 participated in the misconduct or who knowingly or recklessly provided false information.

Subtitle D—Right to Financial Privacy Act Amendments

SEC. 941. DEFINITIONS.

This provision would expand the list of financial institutions agencies covered by the Right to Financial Privacy Act ("RFPA"). Specifically, it would include those agencies which regulate (1) financial institution holding companies and (2) the subsidiaries of holding companies and financial institutions within the definition of "supervisory agency".

SEC. 942. ADDITIONAL EXCEPTIONS.

This provision specifies that information concerning failed institutions may be provided to the Federal deposit insurance agencies by other banking agencies or law enforcement authorities. The amendments create similar exemptions for disclosure to and examination by (1) the Federal Reserve System concerning extensions of credit and (2) the Resolution Trust Corporation.

SEC. 943. PROHIBITION.

This amendment prohibits financial institutions from notifying (a) customers whose financial records have been subpoenaed by a grand jury (in connection with possible violations of crimes relating to financial institutions or false statements) and (b) targets of such investigations, about the existence of the subpoena or the furnishing of the data. Violations

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

of this section fall within the enforcement provisions of the Federal Deposit Insurance Act.

SEC. 944. MISCELLANEOUS PROVISIONS.

This amendment includes the SEC in the group of supervisory agencies which may share information with each other under the RFPA. The amendment will enable the banking agencies to share customer record information under proper circumstances with the SEC.

Subtitle E—Civil Penalties for Violations Involving Financial Institutions

SEC. 951. CIVIL PENALTIES.

Section 951 authorizes civil penalties for conduct that violates certain sections of title 18, United States Code. Section 951(a) provides that a person who violates a provision listed in section 951(c) is subject to a civil penalty.

Sec. 951(b) sets forth the amount of the civil penalty. Sec. 951(b)(1) authorizes a maximum civil penalty of $1 million per day of violation. Section 951(b)(2) provides that for a continuing violation the maximum penalty is the lesser of $1 million per day or $5 million. Section 951(b)(3) authorizes a larger civil penalty if there is a pecuniary loss to a financial institution or pecuniary gain to any person greater than the fines provided for in (b)(1) and (b)(2). In such a circumstance, the civil penalty may equal the loss or gain.

**103 Section 951(c) lists the provisions for which the penalty applies. The provisions covered are: (1) 18 U.S.C. 215 (financial institution bribery), 656 and 657 (financial institution misapplication and embezzlement),*195 1005 and 1006 (false entries in reports on financial institutions), 1007 (fraud on deposit insurers), 1014 (false statement or overvaluation), and 1344 (financial institution fraud); and (2) 18 U.S.C. 1341 or 1343 (mail and wire fraud) if the violation affects a financial institution. Section 951(c) also provides that the civil penalty of section 951 applies to a conspiracy to violate any of those sections.

Section 951(d) authorizes the Attorney General to bring in a United States district court a civil action to recover a civil penalty authorized by this section.[1]

Section 951(e) requires the Attorney General to establish the right to recovery by clear and convincing evidence.

Subtitle F—Criminal Law and Procedure

SEC. 961. INCREASED CRIMINAL PENALTIES FOR CERTAIN FINANCIAL INSTITUTION OFFENSES.

Section 961 increases criminal penalties for offenses in title 18 of the United States Code that affect financial institutions. Section 961(a) amends 18 U.S.C. 215, which deals with financial institution bribery. Section 961(a)(1) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[2] Section 951(a)(2)(A) amends 18 U.S.C. 215 to replace the term "a bank" with the term "an institution" every time the term "a bank" appears. Section 961(a)(2)(B) strikes subsections (b)(2) and (b)(8), two definitions for "financial institutions" which are now obsolete. Section 951(a)(2)(C) renumbers subsections in 18 U.S.C. 215(b).

Section 961(b) amends 18 U.S.C. 656, which deals with financial institution embezzlement. Section 961(b) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[3]

Section 961(c) amends 18 U.S.C. 657, which deals with theft or misapplication of funds in a financial institution. Section 961(c) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[4]

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Section 961(d) amends 18 U.S.C. 1005, which deals with false entries in bank reports for the purpose of defrauding another. Section 961(d)(1) expands section 1005 to cover false entries in bank reports from bank holding companies and savings and loan companies. Section 961(d)(2) and (3) make necessary clerical and technical amendments. Section 961(d)(4) adds a new provision making it an offense ***196** for a person to participate, share, or receive directly or indirectly any money, profit, property, or benefits through a financial transaction with intent to defraud the United States. Section 961(d)(5) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[5]

****104** Section 961(e) amends 18 U.S.C. 1006, which deals with false entries in general credit institution reports for the purpose of defrauding another institution. Section 961(e) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a $10,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[6]

Section 961(f) amends 18 U.S.C. 1007, which deals with false statements in Federal Deposit Insurance Corporation transactions. Section 961(f) condenses the language of 18 U.S.C. 1007 without altering the content. Section 961(f) also expands 1007 to cover all fraudulent conduct regarding Federal Deposit Insurance Corporation transactions (presently dealt with in 18 U.S.C. 1008), and increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 2 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[7]

Section 961(g) repeals 18 U.S.C. 1008, which deals with Federal Savings and Loan Insurance Corporation transactions. The amendment to 18 U.S.C. 1007 in section 961(f) makes 18 U.S.C. 1008 redundant.

Section 961(h) amends 18 U.S.C. 1014, which deals with false statements in loan and credit applications. Section 961(h)(1) through (4) make necessary conforming changes. Section 961(h)(5) and (6) increase the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 2 years and a $5,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[8]

Section 961(i) amends 18 U.S.C. 1341, which deals with mail fraud. Section 961(i) increases the penalty for a mail fraud offense involving a financial institution to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a fine of $1,000.[9]

Section 961(j) amends 18 U.S.C. 1343, which deals with fraud by wire, radio, or television. Section 961(j) increases the penalty for a wire fraud offense involving a financial institution to a fine of $1 million and 20 years imprisonment. The present maximum is imprisonment for 5 years and a fine of $1,000.[10]

Section 961(k) amends 18 U.S.C. 1344, which deals with bank fraud. Section 961(k)(1) increases the maximum penalty to a fine of $1 million and 20 years imprisonment. The present maximum is ***197** imprisonment for 5 years and a $10,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[11]

Section 961(k)(2) makes technical and conforming changes. Section 961(l)(1) adds a new section (3293) to chapter 213 of title 18 of the U.S. Code to provide a 10–year statute of limitations for banking offenses. The present statute of limitations period is five years.[12] New section 3293 applies the ten year statute of limitations to (1) a violation of 18 U.S.C. 215 (financial institution bribery), 656 and 657 (financial institution misapplication and embezzlement), 1005 and 1006 (false entries in reports on financial institutions), 1007 (fraud on deposit insurers), 1014 (false statement or overvaluation), and 1344 (financial institution fraud); (2) a violation of 18 U.S.C. 1341 or 1343 (mail and wire fraud) if the violation affects a financial institution; and (3) a conspiracy to violate any of these sections. Section 962(l)(2) makes necessary conforming changes. Section 961(l)(3) provides that the 10–year period applies to all offenses committed before the enactment of this legislation, as long as the five year statute has not already expired.

****105** Section 961(m) amends 28 U.S.C. 994(p) and section 21 of the Sentencing Act of 1987, which authorize the United States Sentencing Commission to promulgate and amend sentencing guidelines. Section 961(m)(1) directs the Sentencing Commission to assign to a serious banking related offense an offense level of at least a 24. Section 961(m)(2)

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

provides that section 961 applies to violations or a conspiracy to violate 18 U.S.C. 215 (financial institution bribery), 656 and 657 (financial institution misapplication and embezzlement), 1005 and 1006 (false entries in reports on financial institutions), 1007 (fraud on deposit insurers), 1014 (false statement or overvaluation), 1341 or 1343 (mail and wire fraud if the violation affects a financial institution), and 1344 (financial institution fraud) where such offense substantially jeopardizes the safety and soundness of a financial institution. Section 961(m)(3) provides that the requirements of section 961 shall expire on December 31, 1993.

SEC. 962. MISCELLANEOUS REVISIONS TO TITLE 18.

Section 962 makes miscellaneous amendments to title 18 of the U.S. Code. Section 962(a) amends title 18 to replace the term "Federal Home Loan Bank Board" with the term "Office of Thrift Supervision".

Section 962(b)(1) broadens 18 U.S.C. 212, which deals with offers of loans or gratuities to bank examiners, to cover financial institutions and the Office of Thrift Supervision examiners, as well as "banks". Section 962(b)(2) expands 18 U.S.C. 213, which deals with acceptance of loans or gratuities by bank examiners, to include financial institutions other than banks. Section 962(b)(3) repeals 18 U.S.C. 1009. Section 962(b)(4), (5), and (6) and section 962(c) make technical and clerical amendments.

Section 962(d) amends 18 U.S.C. 1510, which deals with obstructing a criminal investigation. Section 962(d) expands 18 U.S.C. 1510, to make it an offense for an officer, director, partner, employee, or attorney of a financial institution knowingly to notify certain persons*198 that a grand jury has subpoenaed the records of a customer, in connection with the investigation of the possible banking offenses listed in 951(c). The persons to whom disclosure is prohibited are (1) the customer whose records are sought, or (2) a target of the grand jury investigation. The maximum penalty is 5 years imprisonment and a fine under title 18 of the United States Code.[13]

Section 962(e) makes conforming amendments to 18 U.S.C. 2113. Section 962(f) makes technical amendments to 18 U.S.C. 215 and makes the definition of "financial institution" set forth in 18 U.S.C. 215(b) applicable to all of title 18, by moving the definition into a separate section (20) of title 18 of the United States Code.

SEC. 963. CIVIL AND CRIMINAL FORFEITURE.

Section 963 provides for civil and criminal forfeiture in connection with title 18 offenses affecting financial institutions. Section 963(a) amends 18 U.S.C. 981, which deals with civil forfeiture. Section 963(a)(1) provides for civil forfeiture for (1) a violation of 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, or 1344; (2) a violation of 18 U.S.C. 1341 or 1343 affecting a financial institution; and (3) conspiracy to violate any of the above sections. Section 963(a)(2) makes necessary conforming changes and authorizes the Attorney General to sell any forfeited property which is not required to be destroyed or is not harmful. Section 963(a)(2) also adds a new provision establishing a priority for the disposition of proceeds that have been civilly forfeited. First, proceeds are used to reimburse out-of-pocket expenses incurred for seizure and forfeiture by the Federal banking agency regulating the financial institution. Second, proceeds go to the Department of Justice to reimburse its out-of-pocket expenses for seizure and forfeiture. Third, if the affected financial institution is in receivership or liquidation, proceeds go to a Federal banking agency regulating the institution, to reimburse the agency for (i) payments to claimants or creditors or (ii) losses suffered by that agency's insurance fund as a result of the receivership or liquidation. Fourth, if the affected financial institution is not in receivership or liquidation, the proceeds go to the General Fund of the Treasury or, upon the order of the appropriate Federal bank regulatory agency, to the affected financial institution as restitution. Amounts received by the financial institution shall be set off against amounts later recovered by the institution as compensatory damages in a State or Federal proceeding.

**106 Section 963(b) amends 18 U.S.C. 982, which deals with criminal forfeiture. Section 963(b)(1) authorizes criminal forfeiture for (1) a violation of 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, or 1344; (2) a violation of 18 U.S.C. 1341 or 1343 affecting a financial institution; and (3) a conspiracy to violate any of those sections. Section

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

963(b)(2) provides that property forfeited for these violations shall be disposed of in accordance with the Comprehensive Drug Abuse Prevention and Control Act of 1970 (12 U.S.C. 853).

*199 SEC. 964. GRAND JURY AMENDMENTS.

Section 964 amends chapter 215 of title 18, United States Code, by adding a new section (3322) to authorize disclosure of certain matters occurring before the grand jury. New section 3322(a) permits the disclosure of such matter to an attorney in the Justice Department for use in imposing a civil penalty provided for in section 951 of this legislation. Such matter may be obtained without a court order.

New section 3322(b)(1) authorizes a court, upon motion of an attorney in the Justice Department, to disclose such matter to identified personnel of a Federal bank regulatory agency for (1) use in relation to matter within the jurisdiction of the agency, and (2) to assist a Justice Department attorney to whom matters have been disclosed under new section 3322(a). New section 3322(b)(2) authorizes a court to issue an order for disclosure only upon a showing of particularized need.

New section 3322(c) requires that matter obtained through grand jury disclosure be used only for imposing section 951 of this legislation in the case of disclosure under subsection (a) or (b)(1)(B), or in relation to matter within the jurisdiction of the regulatory agency in the case of disclosure under subsection (b)(1)(A). New section 3322(d) defines the term "banking law violation" for this section. Section 964(b) is a conforming technical amendment to chapter 215 of title 18 of the United States Code.

SEC. 965. CRIMINAL DIVISION FRAUD SECTION REGIONAL OFFICES.

Section 965 requires that the Justice Department establish new regional offices of the Fraud Section of the Criminal Division. Section 965(a) requires that the Justice Department establish two such offices; one in Northern Texas and one in Southern California, regions which have by far the largest backlog of financial institution fraud cases, within 120 days after the enactment of the legislation. Section 965(b) requires that the GAO conduct a study within 180 after the enactment of the legislation on the possible need for further regional offices or task forces.

SEC. 966. DEPARTMENT OF JUSTICE APPROPRIATION AUTHORIZATION.

Section 966 authorizes appropriations for the next 3 years for investigating and prosecuting financial institution crimes and for civil proceedings involving financial institutions. Section 966(a)(1) authorizes $65 million for investigations and prosecutions for each of the 3 fiscal years. Section 966(a)(2) authorizes $10 million for civil proceedings for each of the 3 fiscal years. Section 966(b) prohibits use of sums otherwise available or the reallocation of authorized funds. Section 966(c) requires that the Attorney General report annually to Congress on the use of these appropriated funds.

TITLE X—STUDY OF FEDERAL DEPOSIT INSURANCE AND BANKING REGULATION

SEC. 1001. STUDY OF FEDERAL DEPOSIT INSURANCE SYSTEM.

**107 The Secretary of Treasury, in consultation with the Federal bank and thrift regulators, the Director of the Office of Management and Budget and individuals from the private sector, shall conduct a study of the Federal deposit insurance system, including an appropriate structure for the offering of competitive products and services*200 consistent with the standards of safety and soundness. Topics to be included in the study are as follows:

1. The feasibility of establishing a Federal deposit insurance premium structure that would consider asset quality risk, interest rate risk, quality of management and profitability and capital on an institution-by-institution basis.
2. Incentives for market discipline, including the advantages of limiting each depositor to one insured account per in-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

stitution; of reducing the amount insured or establishing a graduated scale according to which marginal insurance coverage declines from one hundred to zero percent; of combining Federal with private insurance to bring—market discipline of private insurance to bear on the management of the depository institution; and of ensuring, by law or regulation, that, upon the closing of any financial institution, the appropriate Federal insurance fund will honor only its explicit liabilities, and will never make good any losses on deposits not explicitly covered by Federal deposit insurance.

3. The scope of deposit insurance coverage and its impact on the liability of the insurance funds.

4. The feasibility of market value accounting, assessments on foreign deposits, limitations on brokered deposits, the addition of collateralized borrowings to the deposit insurance base, and multiple insured accounts.

5. The impact on the deposit insurance funds of varying State and Federal bankruptcy laws and the feasibility of uniform exemptions, the feasibility of limits on exemptions when necessary to repay obligations owed to Federally insured depository institutions; and the feasibility of requiring borrowers from Federally insured institutions to post a personal or corporate bond when obtaining a mortgage on real property.

6. Policies to be followed with respect to the recapitalization or closure of insured institutions whose capital is depleted to, or near to the point of, insolvency.

7. The efficiency of housing subsidies through the Federal Home Loan Bank System.

8. Alternatives to Federal deposit insurance.

9. The feasibility of refining the relationship between independent accountants of a financial institution and the regulator of that institution.

The report shall be submitted to the Congress within eighteen months from the date of enactment.

SEC. 1003. SURVEY OF BANK FEES AND SERVICES.

The Federal Reserve Board shall conduct an annual survey of the retail banking services provided by insured financial institutions and the fees imposed for these services. The report shall include any discernable trend with respect to any increase or decrease in the number of services provided by depository institutions, the number of services for which a separate fee is required and all fees imposed for such services. The report shall also contain a description of any correlation between the fees imposed for services and the cost of such services, a breakdown of the extent to which the profits of an institution are attributable to fees imposed, ***201** and a description of any correlation between increased deposit insurance premiums and an increase in either the amount of fees imposed or the number of services for which a separate fee is imposed. This report shall be submitted no later than June 1, 1990 and each year thereafter.

SEC. 1004. LIMITATION ON EXPANDING DEPOSIT INSURANCE COVERAGE DURING STUDY PERIOD.

****108** Except in certain circumstances described in the bill, the FDIC is prohibited from taking any action that would extend deposit insurance coverage to any obligation which was not treated as a deposit prior to April 6, 1989. This limitation shall end 6 months after the Treasury submits to Congress the report required under Section 1001.

SEC. 1005. GENERAL ACCOUNTING OFFICE STUDY.

Within eighteen months from the date of enactment, GAO shall report to Congress the results of a study of deposit insurance issues raised in Section 1004, emphasizing in particular: an analysis of the policy considerations affecting the scope of deposit insurance coverage; an evaluation of the risks associated with bank insurance contracts both as to the issuing institution and the deposit insurance funds; the effect of proposed changes in the definition of the term "deposit" on market discipline and the ability of other participants in capital markets to raise funds.

SEC. 1006. ANNUAL REPORT ON THE CONDITION OF THE FEDERAL DEPOSIT INSURANCE FUNDS.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

On January 31, 1990, and on or before January 31 of each succeeding year, the FDIC shall report to Congress on the condition of the Federal deposit insurance funds.

TITLE XI—REAL ESTATE APPRAISAL REFORM AMENDMENTS

SEC. 1101. ESTABLISHMENT OF APPRAISAL SUBCOMMITTEE OF THE FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL (FFEIC).

This Section establishes within the FFEIC an Appraisal Subcommittee whose members shall be the designees of the heads of the agencies comprising FFIEC. Each designee shall be a person who has demonstrated knowledge and competence concerning the appraisal profession.

SEC. 1102. FUNCTIONS OF APPRAISAL SUBCOMMITTEE.

The functions of the Appraisal Subcommittee include: monitoring State appraiser certification and licensing systems; monitoring appraisal standards and determinations regarding which Federally related transactions will require the use of certified appraisers and which licensed appraisers; maintaining a national registry of certified and licensed appraisers; maintaining a national registry of certified and licensed appraisers eligible to perform work in Federally related transactions; and monitoring the work of the Appraisal Foundation, a nonprofit corporation of the appraisal industry.

*202 SEC. 1103. CHAIRPERSON OF APPRAISAL SUBCOMMITTEE; TERM OF OFFICE; MEETINGS.

The Chairperson will be selected by the FFIEC and be subject to Title 5 of the United States Code relating to competitive service, classification and the General Schedule pay rates.

SEC. 1104. APPRAISAL SUBCOMMITTEE OFFICERS AND STAFF.

Officers and staff may be appointed by the Chairperson as necessary to carry out the functions of the Appraisal Subcommittee.

SEC. 1105. POWERS OF APPRAISAL SUBCOMMITTEE.

The Appraisal Subcommittee will have those administrative powers as needed to carry out its function.

SEC. 1106. PROCEDURES FOR ESTABLISHING APPRAISAL STANDARDS AND REQUIRING THE USE OF CERTIFIED AND LICENSED APPRAISERS.

**109 The establishment of appraisal standards and other requirements will be subject to the publication of notice and receipt of public notice or the holding of public hearings and other provisions as prescribed in accordance with procedures set forth in Section 553 of Title 5 of the United States Code.

SEC. 1107. AUTHORIZATION OF APPROPRIATIONS.

A one-time, 2–year appropriation of $5,000,000 is authorized to the Appraisal Subcommittee for start-up purposes.

SEC. 1108. ROSTER OF STATE CERTIFIED OR LICENSED APPRAISERS; AUTHORITY TO COLLECT AND TRANSMIT FEES.

The Appraisal Subcommittee is authorized to maintain a roster of all State certified and licensed appraisers eligible for

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Federally related transactions; and to collect from eligible appraisers who perform or seek to perform Federally related work at an annual registration fee of not more than $50. These fees are to be used to fund the activities of the Appraisal Subcommittee, to repay the Treasury, and to help defray certain expenses of the Appraisal Foundation.

SEC. 1109. FUNCTIONS OF THE FEDERAL FINANCIAL INSTITUTIONS REGULATORY AGENCIES RELATING TO APPRAISAL STANDARDS.

Each Federal financial institution regulatory agency and the Resolution Trust Corporation is required to establish appraisal standards that meet the minimum requirements adopted by the Appraisal Foundation; but this section permits additional standards as required by law.

SEC. 1110. TIME FOR PROPOSAL AND ADOPTION OF STANDARDS.

Appraisal standards will be proposed no later than 6 months and adopted no later than 12 months after enactment.

SEC. 1111. FUNCTIONS OF THE FEDERAL FINANCIAL INSTITUTIONS REGULATORY AGENCIES RELATING TO APPRAISER QUALIFICATIONS.

Affected Federal agencies and the Resolution Trust Corporation are required to determine which categories of real estate related financial transactions requiring an appraisal, should be performed either by a certified appraiser or by a licensed appraiser.

***203** SEC. 1112. TRANSACTIONS REQUIRING THE SERVICES OF A STATE CERTIFIED APPRAISER.

All Federally related transactions involving property with a value of $1,000,000 or more shall be performed by a certified appraiser. The Section provides additional guidelines concerning the use of certified appraisers.

SEC. 1113. TRANSACTIONS REQUIRING THE SERVICES OF A STATE LICENSED APPRAISER.

All Federally related transactions not requiring the services of a certified appraiser shall utilize a certified or licensed appraiser.

SEC. 1114. TIME FOR PROPOSAL AND ADOPTION OF RULES.

The determination regarding categories of transactions that will use certified or licensed appraisers will be proposed no later than 6 months and adopted no later than 12 months after enactment.

SEC. 1115. CERTIFICATION AND LICENSING REQUIREMENTS.

State certified appraisers shall meet the requirements for certification issued by the Appraisal Foundation, including a passing grade and a uniform examination; and that licensed appraisers shall satisfy the requirements for licensing in a State or territory. Federal agencies and instrumentalities and Federally recognized entities are authorized to establish additional appraiser certification and licensing qualification criteria.

SEC. 1116. ESTABLISHMENT OF STATE APPRAISER CERTIFYING AND LICENSING AGENCIES.

****110** States are authorized to establish appraiser certification and licensing agencies.

SEC. 1117. MONITORING OF STATE APPRAISER CERTIFYING AND LICENSING AGENCIES.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The Appraisal Subcommittee is required to monitor State certifying and licensing agencies. The Section prohibits the recognition of certifications and licenses from States whose appraisal policies, practices or procedures are found to be inconsistent with the purposes of the amendment. Criteria is established for rejecting a State's appraiser certification and licensing system and due process safeguards are provided including judicial review of any such determination.

SEC. 1118. RECOGNITION OF STATE CERTIFIED AND LICENSED APPRAISER FOR PURPOSES OF THIS TITLE.

The date, July 1, 1991, is established as the date after which appraisals performed in Federally related transactions must be performed by State certified or licensed appraisers. An extension of this date is permitted to December, and the Appraisal Subcommittee is allowed to waive, temporarily, any requirement pertaining to certification and licensing in a State, if such requirement led to inordinate delays in the performance of Federally related appraisal in that State.

SEC. 1119. VIOLATIONS IN OBTAINING AND PERFORMING APPRAISALS IN FEDERALLY RELATED TRANSACTIONS.

Fannie Mae, Freddie Mac and the Resolution Trust Corporation are required to use certified and licensed appraisers, no later than July 1, 1991, in connection with their activities. A civil fine is established for financial institutions that knowingly obtain an appraisal*204 in a Federally related transaction from an individual who is not State certified or licensed, as required.

SEC. 1120. DEFINITIONS.

This Section provides definitions, including the term "Federally related transaction."

SEC. 1121. MISCELLANEOUS PROVISIONS.

This Section provides for recognition, among the States, of each other's certifications and licenses in connection with temporary practice and prohibits discrimination against certified and licensed appraisers solely by virtue of membership or lack of membership in any particular appraisal organization.

TITLE XII—MISCELLANEOUS PROVISIONS

SEC. 1201. INDEPENDENT ANNUAL AUDITS OF INSURED FINANCIAL INSTITUTIONS.

Section 1201 of the Committee's reported bill requires (1) the management of financial institutions to prepare reports on their internal control structure and compliance with specific laws and regulations related to safety and soundness, and (2) independent public accountants to perform annual financial statement audits of banks and thrifts, coupled with a review of management's assertions contained in the internal control and compliance reports.

The bill requires the FDIC to establish the form and content of the management reports, including the laws and regulations related to safety and soundness on which management will report. To the extent practicable and consistent with the purposes of this section, the FDIC must recognize and specify criteria and guidance developed by recognized private sector bodies.

**111 The form and content of the auditor's report shall conform with applicable attestation standards of recognized auditing standards setting bodies and will be prescribed by FDIC, in consultation with the Comptroller General of the United States, after public notice and opportunity for comment.

The FDIC shall also prescribe alternative auditing and reporting requirements for insured banks with assets less than $150 million. In prescribing alternative requirements under this subsection, the FDIC shall consider the cost of comply-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ing with such requirements.

The reporting requirements of this section apply to fiscal years which begin 18 months after the date of enactment.

SEC. 1202. STUDY OF STRUCTURE AND CONDITIONS OF CREDIT UNION SYSTEM.

The Comptroller General, in consultation with other financial regulatory agencies, shall conduct a study of the structure of the National Credit Union Administration, including the role of credit unions, the financial condition of the national credit union system, and the funding of the National Credit Union Share Insurance Fund, credit union supervision at the state and federal level, credit union capital levels, credit union bond issues and an appropriate structure for the offering of competitive products and services to consumers consistent with standards of safety and soundness. A report of this study shall be submitted to Congress within 18 months of enactment.

*205 SEC.1203. OCC EMPLOYMENT PROVISION.

The Comptroller of the Currency, after consultation with the Secretary of the Treasury, is authorized to fix the number and compensation of employees of the OCC and to make a report thereof to Congress. This section also provides that such compensation shall be determined by the Comptroller without regard to the provisions of any other law, including any provision of Title 5 of the United States Code and that in setting and adjusting such compensation the Comptroller shall seek to maintain comparability with the compensation at the other banking regulatory agencies.

SEC. 1204. NCUA EMPLOYMENT PROVISION.

The National Credit Union Administration Board is authorized to appoint employees without regard to Title 5 of the United States Code. The Board, in setting and adjusting compensation shall try to maintain comparability with other banking regulatory agencies. The salaries and expenses of that Board and employees of the Board are to be paid from assessments paid by the credit unions.

SEC. 1205. EXPANSION OF USE OF UNDERUTILIZED MINORITY BANKS, WOMEN'S BANKS AND LOW INCOME CREDIT UNIONS.

The Secretary of the Treasury shall consult with the Federal banking agencies and the National Credit Union Administration on methods to increase the use of underutilized minority banks, women's banks and low-income credit unions as depositories for federal agencies. The Secretary of the Treasury, the National Credit Union Administration and the Federal banking regulatory agencies shall report on their findings to Congress within six months of the date of enactment of this legislation.

SEC. 1206. CREDIT STANDARDS ADVISORY COMMITTEE.

**112 An eleven-member panel is established, comprised of the heads, or their designees, of five Federal banking regulatory agencies along with six public members (no more than three from the same political party) selected by the President. The Committee shall review, prepare comments and recommendations on the credit standards and lending practices of insured institutions and the supervision of such standards and practices by the Federal banking regulatory agencies and shall monitor the credit standards and lending practices of Federally insured financial institutions. The Committee will submit a report to Congress no later than January 30 of each year.

SEC. 1207. MINIMUM REQUIREMENTS FOR ACCREDITATION OF STATE DEPOSITORY INSTITUTION SUPERVISORY AGENCIES AND FOR STATE EXAMINATIONS OF FEDERALLY REGULATED OR INSURED INSTITUTIONS.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

With the consent of the States, the Federal Financial Institutions Examination Council is directed to establish uniform accreditation standards for State depository institution supervisory agencies and for reviewing the adequacy of State examinations of depository institutions which are also subject to examinations by Federal depository institutions regulatory agencies. This Section also prohibits Federal regulatory agencies from relying solely on any such State examinations in lieu of conducting their own examinations if the State examination is deemed inadequate or the State refuses to allow such review to be made. Using moneys from the appropriate ***206** insuring funds, the Federal regulatory agencies shall reimburse 65% of the costs of training directly related to improving the technical skills of financial institution examiners.

SEC. 1208. COMPARABILITY IN COMPENSATION SCHEDULES.

The FDIC, OCC, NCUA and the OTS shall inform the heads of other agencies and the Congress of the compensation schedules established and adjusted by each of these agencies. These agencies shall seek to maintain comparability in compensation schedules.

SEC. 1209. STUDY BY THE SECRETARY OF THE TREASURY.

The Secretary of the Treasury shall conduct a study and report to Congress on the extent to which Resolution Funding Corporation bonds and other U.S. government securities in small denominations benefit, promote savings and encourage the sale of these securities to small investors. The Secretary shall also recommend measures to expand the availability of small denomination government securities to small investors.

SEC. 1210. EXPENDITURE OF TAXPAYER MONEY ONLY FOR DEPOSIT INSURANCE PURPOSES.

Funds appropriated or borrowed pursuant to an authorization contained in this legislation may be used only for purposes permitted in the bill and may not otherwise be used for making any payment to any shareholder in, or creditor to, any insured financial institution.

SEC. 1211. SEPARABILITY OF PROVISIONS.

If any provision of this Act or the application thereof to any person or circumstances is held invalid, the remainder of the Act and the application of the provision to other persons not similarly situated or to other circumstances shall not be effected thereby.

TITLE XIII—PARTICIPATION BY STATE HOUSING FINANCE AUTHORITIES

SEC. 1301. DEFINITIONS.

****113** This section defines the terms "state housing authority" and "mortgage-related asset" as used in this Title.

SEC. 1302. STATE HOUSING FINANCE AUTHORITY AUTHORIZATION.

This section overrides contrary federal law and state statutory and constitutional law to authorize state housing authorities to purchase mortgage-related assets from the RTC and the FDIC. If such authority has any net income from property purchased from the RTC that income must be applied to the financing, refinancing or rehabilitation of low and moderate income housing within the jurisdiction of the authority.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND

ENFORCEMENT ACT OF 1989

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

EXPLANATION OF LEGISLATION

TITLE I—PURPOSE

The Committee believes in the purposes of the bill as listed in title I and notes that the very first purpose of the bill, as presented by the Administration, is "to promote a safe and stable system of affordable housing finance through regulatory reform." The Committee*207 strongly agrees and has adopted numerous provisions to implement this mandate.

The Committee also endorses the remaining purposes, as listed: To improve supervision by strengthening capital, accounting, and other supervisory standards; to establish a relationship of general oversight by the Treasury Department over the Director of the Office of Thrift Supervision (as successor to certain functions and activities of the Federal Home Loan Bank Board and the FSLIC); to establish an independent insurance agency to provide deposit insurance for savers; to put the Federal Deposit Insurance System on a sound financial basis for the future; to create a new corporation, the Resolution Trust Corporation, to contain, manage, and resolve failed savings associations; to provide the necessary private and public financing to resolve failed institutions in an expeditious manner; and, to provide for improved supervision and enhanced enforcement powers and increase criminal and civil money penalties for crimes of fraud against financial institutions and depositors.

TITLE II—FEDERAL DEPOSIT INSURANCE CORPORATION AUTHORITIES AND RESPONSIBILITIES

Currently, deposits maintained by thrifts are insured by the Federal Savings and Loan Insurance Corporation (FSLIC) which is under the administrative control of the Federal Home Loan Bank Board (Bank Board). This arrangement has been criticized by many commentators and witnesses before the Committee. The current scheme creates a conflict of interest between the FSLIC, whose purpose is to maintain the integrity of the deposit insurance fund, and the Bank Board, whose purpose is to promote and regulate thrifts. The proposed bill addresses this problem by separating the insurance and regulatory functions. The insurance functions are placed in the Federal Deposit Insurance Corporation; the regulatory functions are placed in the new Office of Thrift Supervision.

Title II generally amends the Federal Deposit Insurance Act (FDI Act) to establish the Federal Deposit Insurance Corporation (FDIC) as the insurer of savings associations. However, Title II establishes two different insurance funds—the Bank Insurance Fund (BIF) to insure banks and the Savings Association Insurance Fund (SAIF) to insure savings associations.

Conversions

**114 Section 206 establishes a new provision governing conversions of insured financial institutions. Generally, conversion transactions include: a change of status, whether by charter conversion or otherwise, from a BIF member to a SAIF member and vice versa; the merger or consolidation of a BIF member with a SAIF member; and transfers of more than 10 percent of an institution's deposits or assets by a BIF member to a SAIF member and vice versa. The FDIC may not permit any conversion transactions for a five year period beginning on the date of enactment of the FIRRE Act. The Committee believes that this moratorium is necessary to insure that those institutions that have benefitted from having a savings and loan charter pay their fair share of the bailout and to provide for a stable and increased premium income to reduce the amount *208 of taxpayer funds ultimately needed to resolve the crisis. The FDIC may allow a conversion transaction during the moratorium if the conversion would be in the best interests of the BIF and the SAIF.

Any insured financial institution that leaves either the BIF or the SAIF through a conversion transaction must pay an exit fee in an amount to be determined by the FDIC. Generally, exit fees paid by financial institutions leaving the SAIF are paid to the SAIF. However, the Committee adopted an amendment that provides the Secretary of the Treasury with the authority to direct that exit fee payments of SAIF members be made directly to the Financing Corporation if the Fin-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ancing Corporation has exhausted all other sources of funds available to pay interest on its obligations, including assessments on SAIF members.

Commonly controlled financial institutions

Section 206 provides that an insured financial institution may be liable to the FDIC for any loss the FDIC may incur in connection with the failure of or assistance provided to a commonly controlled insured financial institution. An insured financial institution's liability to the FDIC under this provision is superior to any obligation subordinated to depositors or other general creditors, any obligation to shareholders, any obligation or liability owed to any other commonly controlled company or commonly controlled insured financial institution, and any contingent liability. The liability to the FDIC is subordinate in right of payment to deposit liabilities (except those owed to commonly controlled insured financial institutions), to secured obligations, and to other general or senior liabilities.

The Committee adopted an amendment that clarifies the status of senior debt holders under this section. It is the Committee's intent that holders of a commonly controlled insured financial institution's senior debt are superior in right of payment to a claim by the FDIC under this section. The Committee recognizes the senior debt holders' reliance, when making their credit decision, on the financial condition of the commonly controlled insured financial institution absent the imposition of a claim by the FDIC under this section and recognizes the dilution of the claims of senior debt holders that would result if an FDIC claim under this section was entitled to equal payment preference.

**115 The Committee accepted an amendment to limit the amount of any claim by the FDIC under this section in the case of a loan made prior to February 22, 1989, by a financial institution to an insured financial institution which was secured by a majority of the voting stock of that insured financial institution. The Committee intends that this provision would apply only to one particular institution.

The Committee also accepted an amendment that provides a limited transition rule for an acquisition by a bank holding company consummated on May 1, 1987, and an acquisition by a bank holding company consummated on January 29, 1988, of financial institutions in economically distressed areas.

The amendment excepts from the definition of commonly controlled any financial institution which acquired control of another financial institution by virtue of the acquisition of voting shares *209 when such shares served as collateral on a loan which has been defaulted upon, so long as the shares are disposed of within the time period specified and so long as the institutions comply with the provisions of section 23A and 23B of the Federal Reserve Act.

Designated reserve ratio

Section 208 sets new Federal deposit insurance premiums that are higher than historical assessment rates for both banks and thrifts. The Committee's intention is to provide a strong cash flow to the BIF and the SAIF to permit them to rapidly build their reserves to the designated reserve ratio and to maintain that ratio thereafter. The reserve ratio is the net worth of the insurance fund to the total insured deposits in that fund. The designated reserve ratio is defined to be 1.25 percent. The designated reserve ratio may be raised to a higher level not to exceed 1.50 percent. This authority may be exercised only if the FDIC Board of Directors determines by majority vote that the increase is "justified by circumstances that raise a probable risk of substantial future losses" to the insuring fund. The Committee intends that this authority would not be exercised unless the losses are expected to so reduce the Fund reserve ratio that investment and assessment income will not be sufficient to restore the Fund to its designated reserve ratio in a reasonable time period. The Committee also intends financial institution regulators to closely supervise and regulate banks and savings associations to protect the resources of the BIF and the SAIF and to maintain the Funds at the designated reserve ratio.

Assessment rates

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The FDIC is required to set assessment rates for insured financial institutions annually and to announce the assessment rate by June 30 of each year for the succeeding calendar year.

The BIF assessment rates are set at one-twelfth of one percent until December 31, 1989; 12 one-hundredths of one percent from January 1, 1990 through December 31, 1990; and 15 one-hundredths of one percent thereafter.

The SAIF assessment rates are 20.8 one-hundredths of one percent until December 31, 1990; 23 one-hundredths of one percent from January 1, 1991 until December 31, 1993; and 18 one-hundredths of one percent thereafter.

**116 In any year in which the reserve ratio is expected to be below the designated reserve ratio, the FDIC may set a higher assessment rate that is calculated to restore the reserve ratio to 1.25. Until 1994, no such higher assessment rate can be imposed so long as the respective insurance fund reserve ratio is rising on a calendar year basis. The assessment rate imposed on either BIF or SAIF members cannot exceed 35 one-hundredths of one percent, and the maximum increase in any year is one-tenth of one percent or 50% of the prior year's assessment, whichever is greater. The minimum assessment is $1,000 per annum.

Section 208 requires the FDIC to maintain and operate the BIF and the SAIF as separate entities and specifies that premium assessment rates, reserve ratios, and expenses for each Fund shall be determined independently.

*210 Supplemental reserves and earnings participation accounts

Reserves necessary to meet a designated reserve ratio higher than 1.25 percent are to be maintained as "Supplemental Reserves." The FDIC is to distribute the supplemental reserves to members of the fund if and to the extent it determines reserves in excess of the designated reserve ratio are no longer necessary. Supplemental reserves, however, are not to be reflected as an asset of any kind on the balance sheets of insured institutions. A redistribution of supplemental reserves is to be treated as income.

Investment income earned on supplemental reserves is to be allocated to an "Earning Participation Account" and distributed at the end of each calendar year to members of the respective funds.

Risk-based premiums

Deposit insurance premiums currently are assessed on a flat-rate basis. The Committee adopted an amendment authorizing the FDIC to establish risk-based premium assessment categories and rates for the BIF after 1991 and the SAIF after 1994. The Committee expects that risk-based premiums will significantly moderate the risk taking of insured financial institutions.

The provision permits the FDIC to establish risk-based premiums based on categories of institutions that present particular types of risk to the insurance funds. The risks may be greater or lesser than those presented by the "typical" institution; this provision gives the FDIC the ability to reflect that risk profile in the assessment rates.

Recognizing that a fundamental purpose of financial institutions is to meet the credit needs of all sectors of the economy, including low and moderate-income households, small businesses, and family farms, the Committee intends that the FDIC not adopt a schedule of risk-related rates that has the effect of allocating credit away from such groups.

Assessment credits

Section 208 provides that once the designated reserve ratio has been attained by a fund, assessment credits will be made to fund members. No assessment credits may be given when the fund is expected to be below the designated reserve ratio. The intention is that assessment credits will be calculated to maintain the designated reserve ratio after taking into consideration anticipated fund operating expenses, case resolution costs, investment income, and premium income.

Fund eligibility and definitions

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**117 This section establishes eligibility for BIF and SAIF membership. Generally, any savings association, other than any Federal savings bank chartered pursuant to section 5(o) of the Home Owners' Loan Act ("HOLA"), shall be eligible for membership in the SAIF. Any insured financial institution that is not a SAIF member—generally banks, including State savings banks—shall be a BIF member. The provision retains present law allowing a federal association to convert to a State savings bank and provides that associations exercising the conversion option shall retain their SAIF membership. *211 Such institutions would therefore be able to convert their charters during the moratorium and without triggering a requirement to pay exit fees and entrance fees.

Termination of insurance

New section 8(t) of the FDI Act requires the FDIC to consider the extent of a solvent savings association's low-to-moderate income housing loan when making any determination regarding the termination of insurance. A similar provision was added to the HOLA requiring the Director of the Office of Thrift Supervision to consider the extent of a solvent savings association's low-to-moderate income housing loans before a decision to appoint a conservator or receiver for the association is made. The Committee believes that low-income housing lending is an important factor that should be considered carefully before any decision is made to close or to terminate the insurance of an association that continues to have positive regulatory net worth. The Committee wishes to encourage savings associations to engage in low-to-moderate income housing lending and to encourage the FDIC and the Office of Thrift Supervision to give appropriate consideration to the need for such lending when making regulatory decisions.

Low-to-moderate income housing loans are defined as those secured by residential property costing no more than sixty percent of the average home in the same area. The Committee believes that such loans can make a significant private sector contribution to the nation's supply of low cost housing.

Insured deposits

The Committee adopted an amendment to section 11(a)(3) of the FDI Act to require that mortgage payments placed by lenders in custodial accounts (including principal, interest, taxes and insurance) be insured up to $100,000 on a per borrower basis.

Mortgage lenders receive monthly payments from home borrowers consisting of principal, interest, taxes, and insurance. The funds that are maintained in custodial accounts can only be invested in short-term, liquid accounts and are merely held in these aggregated accounts until tax and insurance bills are due or until principal and interest payments are forwarded to holders. These funds are not available or accessible to investors until the contractually agreed upon date on which they are required to be forwarded.

Conservators and receivers

Section 212(5) defines the FDIC's (and the RTC's) authorities and duties as conservator or receiver in a comprehensive amendment to section 11, subsections (c) through (j) and the addition of subsections (k) through (m) of the FDI Act (12 U.S.C. 1821(c)—(m)). The provisions are designed to give the FDIC as conservator or receiver power to take all actions necessary to resolve the problems posed by a financial institution in default.

**118 The FDIC as conservator has the authority to conduct business, including taking deposits, and performing all functions of the financial institution in its own name and to take other such actions as may be necessary to put the institution in a sound and solvent condition.

*212 The FDIC as receiver has the authority to liquidate the assets and pay the obligations of the institution on behalf of the depositors and creditors; to merge the institution with another insured financial instituion; to organize a Federal savings association to take over the assets and liabilities from a failed thrift; or to organize a bridge bank or a new nation-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

al bank to take over assets and liabilities of any insured bank in default. The Committee has also provided for various claims procedures, taking careful note of recent Supreme Court direction.

The conservator or receiver has the authority to seek a stay of judicial proceedings, in which it or the failed institution is or becomes a party, for a period of up to 90 days after its appointment. The conservator or receiver has the authority to enforce any contract entered into by the failed financial institution that it deems necessary for the orderly execution of its duties, notwithstanding any provision of the contract providing for the termination, default, acceleration, or exercise of rights upon, or by reason of, the institution's insolvency or the appointment of a conservator or receiver (except directors and officers liability contracts and financial institution bonds which are discussed below).

Enforcement of contracts

The bill provides authority for the conservator or receiver to enforce contracts of the insured institution even if the contract includes a provision for termination of coverage upon the government's determination to appoint such conservator or receiver. The same provision excepts directors and officers insurance contracts and financial institution bonds and retains current law for the treatment of such contracts. The exception for directors and officers liability contracts and financial institution bonds is intended neither to expand nor diminish the rights of insured institutions, their insurers, or conservators or receivers. A conservator or receiver or insurer retains the right to litigate the enforceability of coverage exclusions such as those described above that state that upon appointment of a receiver coverage will be terminated. Courts shall continue to address provisions in such contracts and bonds under existing law. This provision is in no way intended to affect or alter the law with respect to directors and officers liability insurance contracts or financial institution bonds. Extensions of credit from a Federal home loan bank or a Federal reserve bank are excepted.

Current law

The majority of courts which have considered the provisions in contracts which provide that coverage terminates upon appointment of a receiver have found such provisions to be against public policy and therefore unenforceable. In a recent case, the Court held that such a clause "substantially hinders FSLIC's exercise of its federal powers and therefore is contrary to federal policy." The Court stated further:

**119 "If the court were to enforce the FSLIC exclusion as written, all of FSLIC's claims, regardless of their origin or status under the policy, would not be covered simply because FSLIC rather than a shareholder, depositor, or third party prosecuted the claim. Private *213 parties to an insurance contract may not frustrate the Congressional purpose behind receivership by annulling FSLIC's federal powers." Branning v CNA Insurance Companies, U.S. District Ct., W.D.Wash. No. C88–764R, April 19, 1989, at p. 8 (emphasis supplied).

For a contrary view, see Continental Casualty Co. v. Allen, et al. U.S. District Ct., N.D. TX, April 3, 1989.

Repudiation of Contracts

The reported bill confirms the authority of conservator or receiver to disaffirm or repudiate contracts. The decision whether to exercise this authority must be made within a reasonable period following appointment and services accepted by the conservator or receiver under a contract before repudiation must be paid as an administrative expense of the conservatorship or receivership. The rights of holders of perfected security interests are protected. Both a creditor and the conservator or receiver acting on behalf of the insured institution may set off mutual obligations owed each other.

The conservator or receiver has the power to disaffirm or repudiate contracts if it determines that the contract would be burdensome and that the disaffirmance or repudiation would promote the orderly administration of the financial institution's affairs. The counterparty's claim for damages is generally limited to actual compensatory damages. In the case of certain Financial Contracts, the damages are measured as of the date of disaffirmance or rejection, and include normal

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

and reasonable costs of cover or other reasonable measures of damages utilized in the applicable industry. The conservator or receiver will be liable for contractual rents under a rejected lease only until the mailing of the notice of disaffirmance, so long as such notice is mailed within 90 days of the date of appointment of the conservator or receiver or the date it discovers the existence of the lease.

The conservator or receiver is authorized to enter into contracts with State Housing Finance Authorites (see title XIII of this Act) for the sale of mortgage related assets of the financial institutions in default. Several factors are to be considered in disposing of such assets, including the State Housing Finance Authority's ability to acquire and service the assets, its ability to further national housing policies, and its sensitivity to the impact of the sale of mortgage related assets upon State and local communities. This subsection allows HFAs to participate in asset disposition of troubled thrifts. To the extent HFAs generate income from these activities, the proceeds are dedicated to low- and moderate-income housing under the bill. However, these assets must be financed. The utilization of tax-exempt financing by the HFAs will save the government money because the Committee anticipates that any revenues from sales of mortgage related assets to HFAs shall be used to reduce the volume of REFCORP bonds. In order to maximize these savings, the Internal Revenue Code Section 103 public purpose definition may have to be clarified to encompass these bonds.

**120 Certain resolutions, orders, directives, commitments, and opinion letters (including general counsel's letters) of the Bank Board and the FSLIC regarding the powers and duties of the FSLIC in either its corporate capacity or its capacity as conservator or receiver, which are in effect as of the date of enactment of the FIRRE Act, *214 remain in effect according to their terms. The FDIC is bound by such letters, however, only with respect to their application to transactions entered into, obligations incurred or purchased, or credit extended prior to the date of enactment of the FIRRE Act. The Committee believes that similar contracts or agreements (including contracts or agreements relating to hedging, risk management, funding or capital market transactions) may be treated in a similar manner.

Consistent with current law, the reported bill provides that no agreement can form the basis of a claim against a conservator or receiver or the FDIC in its corporate capacity unless it is in writing, was approved by the insured institution, and properly approved and maintained in the records of the institution. Counterparties to Financial Contracts may rely in good faith on a written representation which the counterparty has retained in its files.

After the enactment of the FIRRE Act, the FDIC may promulgate rules and regulations concerning the applicability of and means of complying with these various requirements for particular types of agreements in light of the market and trade practices of particular industries and the need for such requirements by insured institutions.

Claims determination

The reported bill directs the FDIC to promulgate rules and regulations establishing a variety of administrative procedures and systems to determine contested claims. These procedures will apply to proceedings conducted by the FDIC and to those conducted by the RTC. After exhaustion of streamlined administrative procedures, a claimant has a choice to either bring the claim de novo in the District Court in which the insured institution had its principal place of business or have the claim determination reviewed by one or more administrative processes. The agency's determination whether to allow a claim must be made within 180 days after the claim is timely filed, unless both parties agree to extend that time period. A notice of disallowance becomes final unless the claimant files an objection within 30 days of the mailing of such notice. Any suit (or motion to renew a suit filed prior to appointment of the receiver) must be brought by the claimant within 60 days after the denial of the claim. Resort to either the District Courts or administrative process is available only after the claimant has first presented its claim to the FDIC.

This construct of administrative resolution and de novo judicial determination is responsive to the constitutional and statutory concerns with the FSLIC's current claims adjudication process as outlined by the Supreme Court in Coit Independence Joint Venture vs. FSLIC (March 21, 1989). In that case, the Supreme Court held that the FSLIC did not have the statutory authority to adjudicate certain State law claims against failed savings and loan associations. In addition, the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Court noted that "serious constitutional difficulties" would be presented by the FSLIC's claims process even if it were authorized by statute, because granting even administrative judges the exclusive authority, with only limited judicial review, to adjudicate certain categories of State law claims under these circumstances may invade the domain reserved for Article III courts *215 provided by the U.S Constitution. Justice O'Connor in that opinion noted, however, that exhaustion could be required if an administrative procedure with clear time limits were established. The Committee believes it has provided a clear set of guidelines for claimants and for the FDIC with reasonable and specific time limits.

**121 The claims determination procedures established by Section 212(5), section 11(1) of the FDI Act as amended, are consistent with the reasoning and concerns expressed in the Coit case. First, exhaustion is a proper prerequisite to further action by a claimant, since clear time limits are established for administrative review of claims. Second, a claimant will (after administrative exhaustion) have the option of presenting its claim in a District Court de novo, or consenting to one of the administrative review processes administered by or acceptable to the FDIC. In the former case, Article III courts will hear the case de novo; in the latter, if a claimant appeals an administrative review, limited judicial review is constitutionally permissible because the decision to use the administrative system is voluntary. Voluntary consent by the claimant to an administrative process should be deemed consent to the limited Article III court involvement in that process. See Commodity Future Trading Comm'n v. Schor, 478 U.S. 833 (1986).

The claims determination procedure set forth in subsection (l) creates a system which not only meets the concerns raised by the Coit case, but also enables the FDIC to dispose of the bulk of claims against failed financial institutions expeditiously and fairly. The exhaustion requirements should lead to a large number of claims being resolved without resort to further procedures. In addition, the administrative procedures, including review procedures, created by the FDIC, if made sufficiently attractive to claimants, should lead to a large number of claimants agreeing to present their claims through these forums rather than in court. Thus, the claim resolution process established in this section should allow the FDIC to quickly resolve many of the claims against failed financial institutions without unduly burdening the District Courts.

There shall be no judicial review of the administrative determination not to allow a claim. Rather, the claimant must file suit or continue a previously filed suit to establish a disallowed claim. The claimant and the FDIC, however, may choose an administrative review.

Alternative dispute resolution

In implementing the subsection (l) requirement for alternative dispute resolution systems, the FDIC should attempt to design dispute resolution systems that are appropriate for the different categories of disputes that arise. Examples of such systems include, but are not limited to, arbitration, mediation, mini trials, summary jury trials, court-appointed masters, private judges, neutral fact-finding, moderated settlement conferences, and other appropriate methods of dispute resolution. Such dispute resolution activity may be conducted by private or governmental entities. The FDIC may publish guidelines for dispute resolution systems for specified categories of disputes if it believes that such guidelines will encourage the use of such programs. Such systems shall offer fact-finding, decision-making and mediation processes which are fair, expeditious, *216 cost-effective, and independent, and which provide finality, without interfering with the option of pursuing other remedies which may be available under State or federal law.

**122 In developing guidance for, and in the actual designing, selecting, or creating of such systems, the FDIC shall take such steps as necessary to encourage the use of such systems and provide incentives for their use. The Committee encourages the FDIC to consult and work closely with governmental and private experts on dispute resolution in establishing such processes and locating entities to conduct these processes.

Appointment provisions

Subsection (d) specifies that, when a conservator or receiver is appointed for an insured Federal institution (or for an

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

insured District bank or District savings and loan association) for the purpose of liquidating it or winding up its affairs, the FDIC must be appointed. The bill authorizes, but does not require, the FDIC to accept appointment as receiver in other circumstances, if appointment is offered: i) to serve as conservator for an insured Federal or District financial institution for the purpose of operating the institution, or ii) to serve as conservator or receiver for a State institution either for operating or for liquidation purposes.

The FDIC acting as conservator or receiver is not subject to the direction or supervision of any other agency or Department in the exercise of its duties (except as may otherwise be provided in the FIRRE Act). The only exception to the rule is where the FDIC has been appointed conservator for an insured Federal institution by that institution's primary regulator, and the institution continues to operate in conservatorship. In such cases, the FDIC shall be subject to the supervision of that primary regulator.

The bill also provides the FDIC with the power currently available to the FSLIC to appoint itself as sole conservator or receiver of an insured State financial institution if the FDIC makes each of two findings. First, either that i) a conservator, receiver or other legal custodian has been appointed for an insured State financial institution (other than by the Office of Thrift Supervision or the Comptroller of the Currency), that the appointment has been outstanding for at least 15 consecutive days, and that one or more depositors is unable to obtain a withdrawal of deposit, in whole or in part; or ii) a State financial institution has been closed by or under the laws of any State. Second, that one or more of the following are true with respect to the institution in default: i) insolvency in that the assets of the institution are less than its obligations to its creditors and others, including depositors; ii) substantial dissipation of assets or earnings due to any violation or violations or law, rules, or regulations, or to any unsafe or unsound practice or practices; iii) an unsafe or unsound condition to transact business; iv) willful violation of a cease-and-desist order which has become final; or v) concealment of books, papers, records, or assets of the institution or refusal to submit books, papers, records, or affairs of the institution for inspection to any examiner or to any lawful agent of the FDIC.

*217 Miscellany

**123 The FDIC is required to keep and maintain a full accounting with respect to the affairs of the financial institution in default and specifies that the accounting shall be available to the institution's shareholders, other regulatory agencies, or any member of the public. The FDIC may destroy records of such institution in default after six years from the date of its appointment as receiver.

Payments of insured deposits made on account of a BIF member may only be made from the BIF, and payments of insured deposits on account of a SAIF member may only be made from the SAIF. When the FDIC pays insurance to a depositor, the FDIC is automatically subrogated to the depositor's claim against the institution. The automatic right of subrogation now applies only to national banks; Section 212(5) extends it to all insured financial institutions. The FDIC is permitted to use its Deposit Insurance National Bank powers in the case of failed thrifts as well as in the case of failed banks, but does not otherwise change the role or powers of Deposit Insurance National Banks.

Hostile takeovers

As a result of this legislation, billions of dollars of direct and indirect government assistance will be made available to resolve the thrift crisis. The Committee recognizes that as the FDIC deploys these resources to dispose of the many failed or failing thrift institutions, the least expensive assistance package in some cases may require the FDIC to assume equity positions in the surviving entities. The Corporation has accepted such equity interests in addressing several recent bank failures.

Although there is general agreement that the Federal government should avoid taking ownership positions in private enterprises, the Committee acknowledges that FDIC equity positions can be an appropriate, temporary measure for dealing with bank and thrift failures. The Committee is concerned, however, with the possibility of leveraging this govern-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ment assistance to launch hostile takeovers of privately-owned financial institutions. As the Federal Reserve Board recently noted, "Consideration must be given to expansion of activities where the growth is in effect being financed with public funds." The Committee believes that such use of government ownership can unfairly handicap privately owned financial institutions.

To address these and related issues, the Financial Institutions Subcommittee will schedule hearings on hostile takeovers in the financial institutions industry and on the policy questions that arise when the FDIC accepts equity positions in financial assistance transactions.

As mentioned above, the Committee understands that the Federal bank regulatory agencies are sensitive to the significant policy issues raised by hostile takeover transactions in this context. The Committee expects that the agencies will fully factor these policy considerations into their review of particular transactions pending further congressional action.

*218 Assistance provisions

**124 The Committee has taken several actions that affect the provision of assistance to savings association. Section 13 of the FDI Act is amended to authorize the FDIC to provide assistance to insured savings associations in the same manner as it is provided to insured banks. The Committee also adopted a provision relating to the provision of assistance by the Resolution Trust Corporation to certain savings associations that engaged in supervisory mergers or acquisitions.

Advertising by insured financial institutions

Section 219(1) requires the FDIC to promulgate regulations to provide that advertisements may not refer to or exploit the presumed weakness of a particular insurance fund. The advertising limitations are not intended to apply to affirmative advertising, such as "Serving the community for 50 years" or "The oldest depository institution in the county."

Activities of subsidiaries of state savings associations

Section 18(m)(6) of the FDI Act as added by section 219(5) of the bill allows those thrifts that met their capital requirements on December 31, 1988, and that continue to meet their capital requirements (or are on a capital plan acceptable to the appropriate federal banking regulator) to maintain current levels of activities in their subsidiaries without having to deduct from their capital any investments in or loans to subsidiaries engaging in activities not permissible for national banks.

Each thrift engaging in these activities must meet and continue to meet the capital requirements established in the legislation. If a thrift does not have the tangible capital required by this bill, it will be required to separately capitalize those subsidiaries engaging in these activities. Under a corresponding amendment to section 314, thrifts will be required to hold risk-based capital against all assets, whether held in the parent or the subsidiary. The section explicitly permits the Director of the Office of Thrift Supervision and the FDIC to order a particular savings association or savings associations generally to refrain from engaging in certain activities if they find that those activities constitute a serious threat to the insurance fund or to the safety and soundness of a savings association.

Finally, the Committee notes that sections 219(5) and 315 are not in conflict. Section 315 limits the ability of State savings associations to engage directly in equity investment activities not permissible for Federal savings associations. The Committee intends that the prohibitions of section 315 do not apply to those activities and investments permissible under section 219(5).

FDIC standard of review

Several sections of this legislation give the Board of Directors of the FDIC and the Director of the Office of Thrift Supervision authority to restrict or otherwise regulate the direct and indirect activities of Federal and State chartered associ-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ations. For example, Section 219 gives regulators the power, on an individual or general basis, to restrict a specific type of investment activity. Similarly, *219 Section 314 gives regulators power to establish risk-based capital weightings for various assets, and Section 315 gives the FDIC authority to permit investments in service corporations under certain circumstances. The Committee believes these and other regulatory powers are vital to protecting the insurance fund against intolerably risky investment activities of savings associations. At the same time, the Committee intends that this authority be exercised in a prudent and objective manner.

**125 The Committee expects that any general action, such as limits on a specific activity under Section 219 or establishment of risk-based capital weightings under Section 314, should be based on an objective assessment of the relative risks and returns of an investment (e.g., the net profit of an activity relative to its possible losses and the levels of capital and loss reserves that savings associations engaged in the activity at issue must maintain). Capital and loss reserves provide a safety cushion for the savings association and the Fund; even though one investment may be riskier than another, an institution may be safer overall because it has much higher capital for those investments due to the new risk-based capital rules, and it may also have adequate and sufficient loss reserves. In the case of actions against individual savings associations, the regulators should also look at the management expertise and performance record of the savings association. These factors can offer important guides in determining whether there is a serious threat to the Fund.

Risk management training

The bill requires the FDIC to develop and administer training seminars in risk management for its employees and the employees of insured financial institutions. In addition, within a year after date of enactment, section 221 requires the FDIC to report back to the Congress on the feasibility and appropriateness of establishing a formalized risk management training program designed to lead to the certification of Risk Management Analysts.

The financial sector is rapidly becoming more complex and diverse. New instruments to hedge both credit and interest rate risks are being developed and refined. While some federally-insured institutions have used these instruments with success, others have failed to understand the true risks inherent in such instruments, causing losses to both the institutions and the insurance funds. Just as the FDIC should be concerned with institutions having adequate financial capital, so too should it be concerned that institutions have adequate human capital. Accordingly, the Committee bill provides that the FDIC should develop and administer training seminars in risk management to be offered to both its employees and the employees of insured institutions.

Brokered Deposits

The bill amends in section 222, section 3 of the FDI Act to restrict troubled institutions in the use of brokers to increase deposits. Troubled institutions are defined in the subsection as those insured financial institutions determined by the FDIC not to meet their minimum capital requirements for purposes of the brokered deposit limitation. The bill provides that the FDIC may permit *220 troubled institutions to use brokers, on an institution-by-institution basis or on the basis of different categories to be established by the FDIC, if the use of brokers to increase deposits, in its judgment, does not constitute an unsafe or unsound practice. Troubled institutions may continue to use the services of brokers in raising deposit moneys, so long as deposits are not increased above existing levels as a result of such use. Troubled institutions could continue to increase deposits through other means as long as brokers were not used. However, other parts of the bill (new section 5(t)(A)(ii) of the Home Owners' Loan Act, as amended by the bill) limit growth by savings associations (but not other classes of financial institutions) regardless of the source of funds.

**126 The Committee believes that the FDIC should take steps to assure that any prior approval process should not unduly burden an institution's access to needed liquidity. The FDIC may also define "minimum capital requirements" specifically for the purposes of limiting the growth of deposits by troubled institutions; this standard may be different from the standard used in other contexts.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

TITLE III—SAVINGS ASSOCIATION SUPERVISION IMPROVEMENTS

Title III provides the framework for the supervision and regulation of savings associations.

Director of the Office of Thrift Supervision

Section 302 abolishes the Federal Home Loan Bank Board ("Bank Board") and the position of the Chairman of the Bank Board as the chief regulator of the savings and loan industry. The Office of Thrift Supervision is established as a bureau of the Department of the Treasury responsible for the examination and supervision of Federally chartered savings and loans. The Director of the Office of Thrift Supervision ("Director") will have the authority to impose and enforce regulations upon the savings and loan industry. The Office of Thrift Supervision will have powers and authority parallel to the bureau of Treasury which houses the Office of the Comptroller of the Currency, the regulator for national banks. The Director shall be appointed by the President for a five year term with the advice and consent of the Senate. The Director is prohibited from maintaining a direct or indirect financial interest in any member of a Federal home loan district bank ("district bank").

Problems with current Bank Board structure

The new structure created by this legislation would eliminate the concentration of powers and overlapping functions that characterize the current Bank Board. The Bank Board serves simultaneously as the chartering authority for Federal savings and loans and as the industry's chief regulator. The Chairman of the Bank Board is also the operating head of the Federal Savings and Loan Insurance Corporation. Although the Bank Board controls the supervisory machinery that oversees the thrift industry, it has delegated much of this responsibility to the presidents of the 12 district banks. The district bank presidents, entrusted with the responsibility of examination*221 and supervision, are themselves elected directly by the industry—the very industry being examined and supervised by the district banks. The district banks also serve as a credit facility making loans to member institutions.

The system is rife with real and potential conflicts of interest which compromise the integrity of the regulatory, insurance and credit functions of the Federal Home Loan Bank System. This provision seeks to assure a more rational, reasonable and responsive system.

This section would eliminate provisions of H.R. 1278, proposed by the Administration, to assure the tenure of the present Chairman of the Bank Board.

In the opinion of the Committee, the current Chairman of the Bank Board has not effectively executed the responsibilities of the position and has failed to assist Congress in its effort to examine the current crisis in the savings and loan industry. A provision has been included in this section to prohibit the current Chairman, or any current member of the Bank Board, from automatically becoming the Director of the newly created Office of Thrift Supervision without a formal nomination by the President and confirmation by the Senate.

Examiners and supervisory employees

**127 The intent of the Committee is that those employees of the district banks that are experienced in the supervision and examination of thrift institutions shall be retained, to the extent reasonably possible, by the Director of the Office of Thrift Supervision or Federal Deposit Insurance Corporation. Also, the Director of the Office of Thrift Supervision shall seek to maintain comparability in levels of compensation for these employees equal to that of other Federal banking agencies and the National Credit Union Administration.

Congressional oversight

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

In order to maintain an adequate level of Congressional oversight over the activities of Office of Thrift Supervision, the Director must report to Congress on an annual basis and the General Accounting Office is given the authority to audit all activities of the Office of Thrift Supervision.

Principal supervisory agent

The principal supervisory agent of the Director of the Office of Thrift Supervision in each district bank; (1) may not be the president of a district bank, (2) shall report to the chief supervisory official of the Office of Thrift Supervision, and (3) may be removed for cause by the Director of the Office of Thrift Supervision.

Limitation on Treasury oversight authority

The Secretary of the Treasury's oversight and direction over the Director shall not extend, directly or indirectly, to any office or joint office of a district bank which is engaged solely in credit-related or correspondent banking activities authorized under the Federal Home Loan Bank Act.

*222 Delineation of supervisory responsibility

Section 303 provides for the regulation of savings associations and the delineation of the supervisory responsibilities between the FDIC and the Director of the Office of Thrift Supervision. The structure established in the legislation is similar to the structure of commercial bank regulation. National banks are regulated by the Comptroller of the Currency, an office in the Department of Treasury. State chartered banks are regulated by the FDIC, an independent agency. While it is not practical for the structure of savings association regulation to mirror the structure of commercial bank regulation, the Committee found the commercial bank regulatory structure a useful model in its deliberations.

This legislation provides that the Director of the Office of Thrift Supervision is the primary regulator of Federal savings associations. The Committee intends that the Director of the Office of Thrift Supervision have the authority to examine, regulate and provide for the safe and sound operation of Federal savings associations. The legislation requires the Director to encourage savings associations to remain an important source of housing credit and operate in a manner consistent with the principles of safe and sound operation. The Committee views these objectives as complementary and does not intend that the new regulatory and supervisory structure of Federal savings associations should reduce the participation of savings associations in the housing finance market.

**128 The legislation provides that the primary regulator of State savings associations is the FDIC and the Committee intends that the FDIC have the authority to examine, regulate and provide for the safe and sound operation of State savings associations. The FDIC will enforce the regulations promulgated by the Director of the Office of Thrift Supervision which are applicable to State savings associations. Except for regulations applicable to State savings associations promulgated by the Director of the Office of Thrift Supervision, the FDIC shall promulgate regulations to carry out the responsibilities of the FDIC under this Act. The FDIC may use the authority conferred upon it in the Federal Deposit Insurance Act or any other Act.

In most cases the appropriate regulator of a State savings association is the FDIC. However in the case of the capital standards promulgated pursuant to section 5(t) of the Home Owner's Loan Act, the standards are required to be established by the Director of the Office of Thrift Supervision. The Director of the Office of Thrift Supervision shall enforce the capital standards for Federal savings association and the FDIC shall enforce the capital standards for State savings associations.

Federal securities laws specifically exempt banks from registration as brokers and dealers. Section 3(a)(6) of the Securities Exchange Act 1934 defines a bank as follows:

(A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary*223 powers similar to those permitted to national banks under the authority of the Comptroller of the Currency pursuant to the first section of Public Law 87–722 (12 U.S.C. 92a) and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clause (A), (B), or (C) of this paragraph. (Emphasis supplied)

In contrast, savings and loans are not exempted from registration as brokers or dealers. The legislation has substantially increased the role of the FDIC in the regulation of savings associations. The Committee is aware of concerns that the new role of the FDIC in the regulation of savings associations may give rise to assertions that savings associations are banks for the purpose of the Federal securities laws. It is not the intent of the Committee to include savings associations within the definition of the term "bank" for the purposes of the Federal securities laws. The Committee does not intend to permit savings associations to conduct securities activities in any without the benefit of registration as brokers and dealers.

Transfer of sections of the National Housing Act to the Home Owners' Loan Act

**129 Section 303(c) transfers section 410 of the NHA to the section 3(f) of the HOLA. This section restates existing law concerning the participation of savings associations in lotteries. The only changes made by this section are conforming changes needed to accommodate the new regulatory structure and the placement of a NHA provision in the HOLA. The Committee does not intend to modify the prohibitions currently contained in this section.

Sections 303(b), (d) and (e) transfer existing sections of the NHA to the HOLA. These sections make technical and conforming changes to reflect changes in nomenclature. The Committee does not intend for these technical and conforming changes to modify the operation of these sections.

Receiverships

Section 5(d)(6) of the HOLA, as amended by this bill, provides the grounds upon which the Office of Thrift Supervision may appoint a conservator or receiver for a Federally chartered savings association and the FDIC may appoint a conservator or receiver for a State chartered savings association. Under section 5(d)(6)(A), the OTS may appoint a conservator or receiver for a federally chartered savings association on a number of grounds including such grounds as insolvency and an unsafe and unsound condition to transact business. Similarly, the FDIC under amended section 5(d)(6)(C) of the HOLA would be empowered to appoint a conservator or receiver for a state chartered thrift institution on the existence of any one of a number of grounds including grounds such as insolvency or an unsafe and unsound condition to transact business.

*224 The bill clarifies that for purposes of appointing a conservator or receiver the OTS and the FDIC may consider, among other factors, whether the institution's capital is substantially insufficient and/or whether the institution can pay its debts or obligations as they come due.

The purpose of this provision is to affirm that both the OTS and the FDIC have the authority to establish, among other things, a universally-applicable floor capital requirement greater than zero be ow which an institution may be determined to be operating in an unsafe or unsound condition to transact business. It is the Committee's belief that the ability to take such action may enable the regulators to intervene prior to an institution's insolvency and thereby preserve the resources of the insurance funds. Moreover, this provision gives the appropriate regulator discretion to appoint a conservator or receiver for an institution based on those criteria on a case-by-case basis. Similarly, the provision gives the appropriate regulator the ability to act quickly and decisively in a situation where an institution is experiencing a liquidity crisis.

While the bill also contains provisions which could restrict the operations of thrifts that are not meeting their capital

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

requirements, the Committee believes that it is essential that the appropriate Federal banking agencies have clear authority to determine when conditions such as substantially insufficient capital or a lack of liquidity constitute an unsafe and unsound condition, necessitating regulatory intervention through the appointment of a conservator or receiver. In making this determination, however, the appropriate agency should take into account the institution's contribution to low-to-moderate income housing lending as provided in section 312 of this bill, so long as considerations as to safety and soundness take clear precedence.

Conversions

**130 Section 313 preserves the existing provisions of Federal law concerning conversion of savings institutions from mutual to stock. Current Federal regulations governing conversions from mutual to stock form, as well as many State laws that have been patterned after Federal rules, require a converting institution provide its depositors with various rights, including (i) priority subscription rights to the new stock and (ii) a liquidation account specifying what a depositor would receive in the event of a complete liquidation of the institution subsequent to conversion from mutual to stock form (unless such conversion is instituted for supervisory reasons as established under regulations of the Director of the Office of Thrift Supervision or the FDIC). A depositor is not entitled to a mandatory distribution from an institution's net worth or surplus under any other circumstances, including in connection with the conversion from mutual to stock form. These rules therefore protect the interests of the depositors in the mutual institutions and also permit a converting institution to raise capital and thus operate in a safe and sound manner for the benefit of depositors, other customers, and the deposit insurance funds. The Committee intends that these principles continue to be applied after the enactment of this legislation.

*225 Capital standards

Section 314, which requires the thrift industry to meet higher regulatory capital standards, received strong bipartisan support from the Committee. The capital requirements established in the bill are a critical and essential benchmark of financial strength long lacking in savings and loan regulation and will ensure that savings association owners put significant sums of their own money on the line. Capital serves as a cushion, available to absorb losses that would otherwise fall to the insurance fund and the taxpayer. As such, it provides discipline for management of an institution to operate in a prudent and sound manner in order to preserve the ownership's interest.

Strong capital requirements are hard evidence of the Committee's resolve that the savings and loan crisis not be repeated. It adds substance to the promise of "never again."

To protect the taxpayer and insurance funds against thrift operators' high-risk adventures, the Committee insisted that the owners of institutions absorb risk by meeting real and tangible capital standards. A sound tangible capital base is fundamental in promoting the safety and soundness of individual institutions and ultimately the stability of our financial system. Those institutions that operate without real capital are only risking the taxpayers' funds. With solid capital, losses related to risky activities are absorbed by the institutions' owners. Absent real and tangible capital, the first dollar lost is essentially an insurance fund dollar—with the losses ultimately borne by the taxpayer.

Parity with national bank standards

**131 Section 314 is designed to place thrifts on par with the capital standards of national banks by January 1, 1995. The key to this section is the requirement for real and tangible capital. In general, the amendment requires, within 180 days after enactment, the Director of the Office of Thrift Supervision to adopt capital standards no less stringent than the capital standards that apply to national banks. The Director is also required to adopt uniform risk-adjusted asset weighing factors materially equivalent to, and no less stringent than, the risk-based capital standards applied to national banks. The

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

standards established may take into consideration any relevant risks, including credit risk and interest-rate risk.

The Committee's objective in requiring that capital regulations adopted by the Director be comparable to those applicable to national banks is to assure a level of capital commensurate with the risk inherent in thrift portfolios. The Committee recognizes that due to variations between thrift and bank activities and investments, effective administration of thrift and bank capital rules may require differences in the specifics of the various agencies' regulations. So long as the general objective stated above is met, such differences would still be consistent with the Committee's intent.

The Committee also notes that the Bank Board's proposed capital regulation included a provision recognizing that residential mortgages covered by primary mortgage insurance policies issued by approved insurers, which coverage effectively reduced the loan-to-value ratio below 80 percent, represented significantly less risk *226 than other types of private sector credits and warranted a lower capital requirement.

In similar fashion, the proposed risk-based capital rules of the Federal banking agencies, in accordance with the Basle Accord, recognize that residential mortgages that meet "prudent underwriting standards" are entitled to a lower capital charge. The Committee believes that in determining what constitutes "prudent underwriting standards," the banking agencies should recognize, as the Bank Board did in its proposed rule, that primary mortgage insurance underwritten by approved insurers effectively shifts a significant portion of the risk from the lender to a creditworthy insurer. Accordingly, such loans would appropriately bear a reduced capital charge under the principles of the Basle Accord.

Capital standard defined

The new capital standards are to be fully phased in by January 1, 1995, and require adopting two separate measurements of capital adequacy—a core capital standard and a risk-adjusted capital standard. The core capital standard, which is a flat percentage of core capital to total assets, represents the absolute minimum level of capital that an institution must maintain. This standard, which is fixed at 3 percent, must be satisfied solely by those items that will be adopted for national banks and include common stock, noncumulative preferred stock, retained earnings, purchased and retained mortgage servicing rights, deducted by a varying percentage of qualifying intangibles.

**132 The 3 percent core capital standard to be implemented on June 1, 1990, requires that 50 percent of all qualifying intangibles be deducted from core capital. The amount of qualifying intangibles is gradually phased out over time with 66.66 percent deducted by January 1, 1992, 75 percent deducted by January 1993, 87.5 percent Deducted by January 1, 1994 and 100 percent deducted by December 31, 1994. This gradual reduction of qualifying intangibles results in thrift institutions being required to achieve a 3 percent tangible capital standard by January 1,1995, without any intangibles.

Mortgage servicing rights

The capital standards regulation to be promulgated by the Director of the Office of Thrift Supervision shall treat purchased mortgage servicing rights in the same manner as does the FDIC pursuant to its capital standards regulation (as now or hereafter in effect). It is the current policy of the FDIC to permit, on a case by case basis, purchased mortgage servicing rights which are being amortized over a period not to exceed 15 years or their estimated useful life, whichever is shorter, to be included in capital. Accordingly, savings associations will be permitted to include qualifying purchased mortgage servicing in their core capital in a similar manner. Savings associations may also include retained mortgage servicing rights in core capital in the same manner as the FDIC is at that time treating purchased mortgage servicing rights.

The Committee recognizes that the FDIC may wish to modify its position on the treatment of mortgage servicing rights in the future. The Committee expects that it will be consulted in advance *227 and that the FDIC will follow the governing notice and comment rulemaking procedures to ensure that affected institutions will have adequate opportunity to express their views and concerns. The Committee also intends that the FDIC or Director consult with the Committee before making any future changes with respect to the treatment of mortgage servicing rights and similarly provide affected sav-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ings associations an opportunity to express their views and concerns.

It is not the intent of the Committee that the implementation of this provision encourage the selling of mortgage servicing rights. At present, the FDIC permits banks on a case by case basis to treat purchased mortgage servicing rights as tangible assets that are included in capital, but as yet has not provided for similar treatment of self-originated mortgage servicing rights. Since FDIC already recognizes that such mortgage servicing rights have value, and since the Committee believes that this value exists no matter how obtained, the FDIC is directed to take all necessary steps to allow institutions under its jurisdiction to carry mortgage servicing rights on their books as capital whether they are purchased or self-originated.

The Committee understands that mortgage servicing rights are subject to classification, as are other assets of an insured institution. To the extent classified as a result of an examination, the FDIC may direct a valuation allowance to be established, thus diminishing the net asset value. Nothing in this section is intended to imply that this treatment of mortgage servicing rights is to be altered.

**133 In addition to the elements of core capital mentioned above, savings associations may include a certain percentage of qualifying intangibles. Supervisory goodwill and contributed mortgage servicing rights are considered qualifying intangibles and included as a temporary component of core capital with limitations. Supervisory goodwill existing on April 1, 1989, and contributed mortgage servicing rights permitted before April 1, 1989, pursuant to a written action of the Federal Home Loan Bank Board are included in core capital as a qualifying intangible based on the phase out provisions discussed above.

Risk-adjusted capital

The risk-adjusted capital standard employs weighing factors that take into account both credit and interest rate risk for all assets of thrift institutions. The proposed risk-adjusted capital standard for thrifts, which is based upon national bank standards to be adopted, requires institutions that hold assets with greater credit risk to have more capital than institutions with assets having lesser credit risk. The standard also is designed to take into account varying levels of interest rate risk inherent in the operations of many institutions. Overall, the thrift risk-adjusted standard, taken as a whole, may be no less stringent than the national bank risk-adjusted standard.

The risk-adjusted standard as proposed for national banks, which addresses credit risk, has two components, tier 1 and tier 2. The proposed standard for national banks requires achieving a 7.25 percent risk-adjusted capital to asset ratio by January 1, 1991 and a 8 *228 percent risk-adjusted capital to asset ratio by January 1, 1993. The components of tier 1 capital are equivalent to those discussed earlier under the 3 percent core capital standard, except that the tier 1 capital ratio must at least be 3.25 percent by January 1, 1991 and 4 percent by January 1, 1993.

The components of tier 2 may include, but are not limited to: cumulative preferred stock, long term preferred stock, convertible debt, subordinated debt and intermediate preferred stock and allowance for loan and lease losses. Subordinated debt and intermediate preferred stock allowable in tier 2 capital is limited to an amount equivalent to 50 percent of the total of tier 1 capital. Allowance for loan and lease losses allowable in tier 2 capital is limited to a maximum of 1.25 percent of risk-adjusted assets. Overall the amount of capital counted toward tier 2 cannot exceed 100 percent of tier 1 total capital.

In an attempt to maintain a minimum soundness requirement, all qualifying intangibles of savings associations are to be excluded from capital unless the Director of the Office of Thrift Supervision determines that the savings institution's management is competent and in compliance with all applicable laws, regulations, orders, and supervisory directives; and the savings institution's management has not engaged in insider dealing, speculative practices, or any other activities that jeopardized the institution's safety and soundness or contributed to the institution's impaired capital position. This determination may be made in the context of an institution's regular examination and should not be the subject of an application process.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Supervisory goodwill defined

**134 As used in new section 5(t) of the Home Owners' Loan Act, the Committee intends the term "supervisory goodwill" to mean goodwill resulting from the acquisition, merger, consolidation, purchase of assets or other business combination of any savings association where the market value of the assets acquired was less than the market value of the liabilities at the time of the transaction and where the accounting treatment of the goodwill has been approved by the Federal Home Loan Bank Board.

Supervisory goodwill existing on the balance sheet of an institution as of April 1, 1989, as defined above, must be expensed on a straight line basis by systematic charges to income over a specified period in accordance with current Bank Board regulations, but not to exceed 20 years.

Any other goodwill resulting from the acquisition, merger, consolidation, purchase of assets or other business combination that is not covered by a specific contractual understanding or agreement with the Bank Board is not included as a component of capital.

Subsidiary investments and loans

In determining compliance with the new capital standards, an institution must generally deduct from overall capital investments in, and loans to, any subsidiary engaged in activities not permissible for a national bank. Exceptions are provided for subsidiary investments or loans in existence on or before December 31, 1988, and any investment in a subsidiary engaged solely in mortgage *229 banking activities. Institutions chartered as savings banks under state law prior to October 15, 1982, or institutions acquiring their principal assets from an institution chartered under state law prior to this date are not affected by this provision.

For purposes of assessing compliance with capital standards, the assets and liabilities of any subsidiary of a savings association shall be consolidated with the assets and liabilities of that institution.

In establishing the permissible activities of national banks as a standard for purposes of this subsection, the Committee recognizes that certain activities permitted for national banks, such as consumer lending, are subject to geographic restrictions that would not apply to savings associations in this context. The Committee intends that a savings association subsidiary engaged in activities permitted for national banks may conduct those activities across state lines, subject to other statutory or regulatory limitations on thrifts, without requiring the savings association's investment in and loans to that subsidiary to be deducted from the capital of the savings association.

Limitation on growth

As noted earlier, the new thrift capital standards will take effect on June 1, 1990, and must be fully implemented by December 31, 1995. However, there are certain limitations which apply both before and after that date. Between the date of enactment and June 1, 1990, thrifts that fail to meet their current capital requirements may, at the discretion of the Director or FDIC, be restricted from increasing their total assets. After June 1, 1990, the Director or FDIC shall prohibit the asset growth of a savings association not in compliance with the newly adopted capital standards, except as noted below.

**135 The Director or FDIC may permit, on a case by case basis, limited asset growth for any institution that fails to achieve the capital standards. Asset growth by undercapitalized thrifts may be permitted up to a maximum amount equal to interest credited on deposits. In order to be exempted from the asset growth prohibition, an institution must apply to the Director or FDIC and obtain supervisory approval. Nevertheless, all growth by an undercapitalized thrift must be in traditional, low risk assets, such as first mortgage loans secured by 1 to 4 family residential real property and fully secured consumer loans. The limited growth permitted for an undercapitalized thrift must be fully supported by a sufficient level of risk-adjusted and core capital.

In addition, prior to June 1, 1990, the Director or FDIC shall require thrifts not in compliance with capital standards to

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

submit for approval a business plan addressing the need for increased capital. The business plan must describe the types of activities the thrift intends to engage in to increase capital, and it must provide that any asset growth will be fully supported by tangible capital under the capital standard in effect. A thrift that violates its business plan will be subject to the full range of enforcement measures.

After June 1, 1990, (subject to other provisions of this section) the Director or FDIC shall place any thrift failing to meet capital requirements under a supervisory agreement which may include restrictions on the payment of dividends and compensation. a limited ***230** exception, at the discretion of the Director or FDIC, is provided for those institutions that will be in compliance with such standards as of the end of the subsequent quarterly reporting period.

Regulatory discretion

Any thrift institution not in compliance with the capital standards may apply to the Director or FDIC for an exemption from any applicable sanction or penalty, including the requirement for a supervisory agreement. Any application submitted for approval must be accompanied by a business plan which addresses the need for increased capital. The business plan must describe the time frames and methods by which the institution will reach full compliance, and it must provide that any asset growth will be fully supported by tangible capital under the capital standard in effect.

In this regard, it was the clear intent of the Committee to provide the broadest possible discretionary authority to the FDIC to review all applications under this provision on a case by case basis. The Committee recognized that a finite and specific statutory requirement, while establishing an appropriate capital standard, could not by itself result in fair and equitable treatment of all individual institutions. The purpose of the application and review process is to allow the regulators to make such assessment of individual institutions.

The Committee intends that the FDIC will give priority consideration to an institution's real and tangible capital ratio and the institution's ability to meet the increasing requirements of subsequent periods. In this regard, an institution that fails the total core capital requirement only because it has little or no qualifying intangibles should not be penalized in comparison to an institution with identical real capital that meets the total core capital requirement because of its qualifying intangibles.

****136** If the application is approved, the only sanction or penalty that shall be imposed for failure to comply with the capital standards is a limitation on asset growth. It is the intent of the Committee that the Director or FDIC shall not have the authority to impose additional sanctions against institutions that are in full compliance with an approved application. However, the Director or FDIC shall deny any application and revoke any prior approval if it is determined that the failure to meet the capital standards is accompanied by any one of the following: (1) a pattern of consistent losses; (2) substantial dissipation of assets; (3) evidence of imprudent management or business behavior; (4) a willful violation of any federal law, any law of any state to which the association is subject, or any applicable regulation; or (5) any other unsafe or unsound condition or activity, other than the failure to meet the capital standard.

Failure on the part of an institution which has been granted an exemption from the supervisory agreement to comply with the provisions of the business plan shall be treated as an unsafe and unsound practice.

Finally, the capital provisions of this section shall not be construed as limiting any authority of the Director or the FDIC, under any provision of this act or any other provision of law, including section 8 of the Federal Deposit Insurance Act, to take any appropriate action such as but not limited to issuing cease and desist or ***231** removal and prohibition orders, entering into written supervisory agreements, or requiring such additional actions as may be necessary to halt unsafe and unsound practices.

Limitation on investments by savings associations

Section 315 provides that in general, a state chartered savings association may not directly acquire or retain an equity investment that is not permissible for a Federal savings association. This provision shall not apply with respect to shares

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

of a service corporation, except as noted below, if (1) the FDIC has determined that the amount invested and the activities engaged in pose no significant risk to the insurance funds and (2) the institution is at all times in compliance with the fully phased-in capital standards.

With respect to the retention of shares of any subsidiary described in section 18(m)(6), the limitation shall not apply to the extent the amount committed is subject to the requirements and limitations which are contained in such section or are imposed by the Director or the FDIC pursuant to such section. Notwithstanding other sections, if an institution held an equity position on May 1, 1989, it may retain such investment in accordance with regulations established by the FDIC. The FDIC shall direct the divestment of any equity interests not permissible under this section no later than June 1, 1994.

Assessment for examination expenses

Section 316 of the bill amends section 9 of the HOLA to establish an assessment for the cost of examination of savings associations and affiliates of savings associations. This section states that the assessment is to be made upon savings associations in proportion to their assets or resources. The language of this provision is patterned after that of Revised Statute section 5240 (12 U.S.C. 481, 482) which authorizes the Comptroller of the Currency to establish an assessment for the cost of examining national banks in proportion to their assets or resources.

**137 In enacting section 316, the Committee does not intend to authorize an inequitable fee arrangement, such as would result from the implementation of a uniform flat rate. Rather, it is aware of the multiple-tier fee structure which the Comptroller of the Currency promulgated in execution of its statute, and intends that section 316 be implemented in a similarly just and equitable manner.

Section 320 amends and transfers section 408(o) of the NHA to section 10(m) of the HOLA. Additional requirements are established as a condition of obtaining qualified thrift lender status. In order to meet the qualified thrift lender requirement a savings association must have 60 percent of its assets in qualified thrift investments and it must have 80 percent of its assets in qualified new thrift investments.

Qualified thrift lender requirements

New section 10(m)(1)(a) of the HOLA ("the 80/20 test") is intended to get savings associations back to their original purpose; to finance housing. The Committee found that the active participation of the savings and loan industry has been essential in meeting the housing needs of the country. In testimony before the Subcommittee*232 on Financial Institutions Supervision, Regulation and Insurance, Federal Reserve Board Chairman Alan Greenspan stated "there is no substitute for a savings and loan." The 80/20 test is intended to return savings associations to their original role as providers of affordable housing finance.

The Committee felt that H.R. 1278 as introduced did not place sufficient emphasis on residential financing. The 80/20 test is intended to require savings associations to meet a qualified thrift lender test that forces the institution back to its traditional role.

The Committee is concerned that the credit needs of low and moderate income people are not being met. Savings associations must do more to help house low and moderate income Americans. The 80/20 test encourages savings associations to loan to, or participate in, the development of starter homes priced at less than 60 percent of the median value of comparable homes in a community. This will reward savings associations that provide young and working class families with housing they can afford. It has become all too common that in this country the store clerk, the postman or the carpenter cannot afford to live in the communities in which they work.

Credit is also scarce in economically depressed areas. The inability to obtain credit at reasonable rates is a major factor in the decline of many communities in our nation. Without access to credit, incentive is discouraged and the social support provided by family, schools, churches and neighborhood businesses is disrupted. Residents of inner city neighborhoods with strong credit ratings often find it impossible to get home financing and are forced to leave. Small business, an

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

essential provider of jobs are not adequately served at present.

**138 In recognition of the special needs of these communities the Committee supported provisions that provide double credit for the value of loans for starter homes and for residential, church, school, nursing home and small business loans in economically depressed areas.

Mutual holding companies

Section 320 contains provision designed to clarify the operation of mutual holding companies. The Competitive Equality Banking Act of 1987 ("CEBA") provided for the establishment of mutual savings and loan holding companies ("MHCs"). As the Federal Home Loan Bank Board sought to implement regulations to govern the creation and operation of MHCs, however, it became apparent that the CEBA provisions regarding MHCs were inadequate in a number of respects. See, 53 Fed.Reg. 41343 (October 21, 1988). The amendments adopted in the FIRREA are intended to clarify the MHC provisions originally enacted in the CEBA.

Under CEBA, a mutual savings association would establish an MHC by transferring its assets and liabilities to a new, stock-form savings association subsidiary. CEBA made no provision for an MHC to obtain an MHC charter in exchange for its old mutual savings association charter. The amendments would address this inadequacy of current law by clearly providing that MHCs will be chartered and regulated by the Office of Thrift Supervision or the FDIC, whichever the case may be.

*233 Mutual savings associations are owned by their depositors. Every depositor in a mutual savings association receives an ownership interest in the savings association commensurate with his or her deposits therein. When Congress enacted CEBA, it intended that MHCs be mutual organizations; that is, that ownership interest in the mutual holding company be tied to deposits in the formerly mutual subsidiary savings associations. Thus, the mutual form of organization would be preserved despite the formal creation of an MHC.

CEBA did not, however, clearly implement Congress' intent that MHCs be mutual organizations. CEBA provided that depositors in a savings association that created an MHC "shall have the same ownership rights with respect to the [MHC]." The CEBA language adequately expressed Congress' intent that ownership rights in the MHC of existing depositors be the same as ownership rights in the predecessor mutual savings association (that is, be commensurate with deposits in such savings association subsidiary). The CEBA provisions do not, however, express Congress' intent that future depositors in a formerly mutual savings association subsidiary of MHC be granted ownership rights in the MHC, thus preserving the on-going mutual nature of the MHC. The amendments address this inadequacy of current law by expressly providing that all depositors in a formerly mutual savings association subsidiary of an MHC shall have ownership rights in the MHC commensurate with their deposits. In addition, the amendments clarify that depositors in a mutual savings association that is subsequently acquired by an MHC will also have ownership rights in the MHC. In situations involving a merger of two MHCs, ownership merger of two MHCs, ownership interests in the disappearing MHC would be converted to ownership interests in the surviving MHC.

**139 Congress intended that MHCs serve mutual institutions as a capital raising mechanism. CEBA, however, provided that the former mutual savings association subsidiaries of an MHC be "wholly-owned" by such MHC. Accordingly, under CEBA, the authority of an MHC to pledge the stock of a formerly mutual savings association subsidiary to raise capital for such subsidiary was unclear. In addition, under prior law, the authority of a formerly mutual savings association subsidiary of an MHC to issue a minority stock interest or a non-voting stock interest to a third party was unclear. The amendments would expressly permit an MHC to pledge the stock of a formerly mutual savings and loan association subsidiary to raise capital for such subsidiary. In addition, the amendments expressly permit formerly mutual savings association subsidiaries of an MHC to issue minority stock interest or non-voting stock interest to third parties. The amendments do not imply any limitation on the authority to pledge or issue stock of a subsidiary the depositors of which do not have ownership interests in the MHC or which is not a savings association, which authority has never been ques-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

tioned.

Because ownership of an MHC is tied to deposits in its formerly mutual savings association subsidiaries, the ownership link between an MHC and such savings association subsidiaries cannot be severed. Accordingly, the amendments provide that in cases of insolvency of an MHC or a formerly mutual savings association subsidiary,*234 or foreclosure on a pledge of stock by an MHC as described above, a trustee will be appointed receiver of such MHC under Chapter 7 of the Bankruptcy Code for purposes of liquidating the MHC. The net proceeds of such a liquidation would be transferable to the FDIC in any case in which the FDIC incurs a loss as a result of a default of the MHC's savings association subsidiary; otherwise the net proceeds would be transferable to the holders of ownership interests in the MHC.

Transactions with affiliates

Section 321 subjects transactions between affiliates of a savings association to the requirements of sections 23A, and 23B of the Federal Reserve Act. In addition, loans to officers, directors or persons who own more than 10 percent of any class of stock of the savings association are subject to the restrictions and prohibitions of section 22(h) of the Federal Reserve Act. Under Current law the Bank Board had enforced the requirements of 23A and 23B on savings and loans and savings and loan holding companies. The Committee is concerned that the Bank Board had imposed a more relaxed standard than the Federal Reserve Board. For this reason the legislation provides that the provisions of 23A, 23B and 22(h) apply to savings associations in the same manner as they apply to banks. The committee believes that a consistent application of these essential safeguards is important. The Committee believes that the Federal Reserve Board is the proper body to interpret the application of these sections of the Federal Reserve Act. The Committee expects that these standards will be applied to savings and loan holding companies in a no less stringent manner as they are applied by the Federal Reserve Board to bank holding companies. The authority of the Director of the Office of Thrift Supervision to impose additional restrictions on transactions between a savings association and an affiliate of such savings association is intended to provide the Director with the authority to impose additional and more stringent standards than are imposed by the Federal Reserve Board on banks and affiliates of banks.

**140 The legislation provides two limited exceptions to the strict application of section 23A. Section 11(d)(1)(A) provides that approvals of the Bank Board made pursuant to section 408(d)(6) of the NHA will remain in effect. In addition, the Committee approved an amendment that permits a savings association to engage in certain transactions if several conditions are met. The most important of these conditions is that the company controlling the savings association assures, to the satisfaction of the Director of the Office of Thrift Supervision, that the company will meet and maintain the capital of the savings association in accordance with the capital standards issued by the director without giving effect to the delay in implementing the standards found in section 5(t) and without consideration for goodwill.

*235 Preservation of minority financial institutions

The Committee adopted an amendment to H.R. 1278 designed to preserve minority ownership of minority financial institutions. Section 328 is intended to ensure that the Federal agencies shall develop and establish programs and policies that support the preservation of minority financial institutions. The programs and policies should promote the growth, development and safety and soundness of existing institutions and especially promote the development of new minority financial institutions. It is the intent of the committee that the Federal agencies' programs should include, but are not limited to, financial, technical, educational and training assistance. Where practical, the agencies should cooperate and establish joint programs and policies targeted toward minority financial institutions.

TITLE IV—DISSOLUTION OF FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION AND TRANSFER OF FUNCTIONS, PERSONNEL AND PROPERTY

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Title IV provides for the orderly transfer of functions and activities of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation to the Office of Thrift Supervision and the Federal Deposit Insurance Corporation or the Resolution Trust Corporation. All regulations and orders of the Bank Board or the FSLIC in existence on the date of enactment (and not otherwise changed or amended by this Act) remain in effect.

Insurance coverage of deposits in savings associations would remain insured under the same provisions for up to 180 days after the date of enactment during which time the FDIC is required to review its regulations and those of the FSLIC and promulgate a uniform set of regulations which shall be applicable to all insured deposits in all insured institutions. The FDIC is also vested with the authority to promulgate and enforce rules to prevent actions by savings associations which could pose a serious threat to the Savings Association Insurance Fund or the Bank Insurance Fund.

The trust estate of participants in deferred compensation plans on deposit or held in trust is to be evaluated for insurance coverage purposes as if each participant were the beneficiary of an irrevocable trust and the interest of the participant fully vested.

**141 Language regarding the transfer of employees is necessary to avoid certain current requirements of the Office of Personnel Management. Under current OPM guidelines regarding transfers, employees are transferred in accordance with the functions on which they spend a majority of their time. In order to avoid all affected transferred employees from being employed by the FDIC, the Committee requires the heads of the involved agencies to jointly determine the functions or activities which must be transferred and then transfer numbers of employees sufficient to carry out such functions and activities.

The legislation requires and it is the strong sentiment of the Committee that the preferences of individual employees of the Bank Board and the FSLIC shall be accomodated as far as possible in the reallocation of personnel between existing and the new agencies established by the legislation.

*236 Any employee accepting employment under the transfer may retain any benefit of, or continue membership in, any employee benefit program. If the employee benefit program is not available at the entity to which the employee transfers, the employee is permitted to select an alternate program. It is also the Committee's specific direction that after enactment of this Act, the officer or agency charged with alloting space in the building formerly housing the headquarters of the Federal Home Loan Bank Board shall continue to provide at least the same amount of space and services to the child development center currently located in that building, which is providing child care to federal employees, as were provided prior to the date of enactment.

In transferring responsibilities from the Bank Board and the FSLIC to the FDIC, and especially in making the FDIC the appropriate Federal regulator of State-chartered savings associations, the FDIC is required, to the maximum extent possible, to use current employees and the regional facilities of the Bank Board and the Federal home loan banks (with respect to employees and facilities of such banks which were involved in the activities which are transferred to the FDIC).

The Resolution Trust Corporation

Title V establishes the Resolution Trust Corporation ("RTC") to manage, merge or liquidate certain conservatorships and receiverships and the Resolution Funding Corporation ("REFCORP") to finance its functions and activities. The legislation provides that the RTC will manage all institutions for which a conservator or receiver was appointed from January 1, 1989 until three years after the date of enactment.

It is the intent of the Committee that the institutions and assets under the jurisdiction of the RTC will be managed and disposed of in a manner that will not impair local real estate markets, return the maximum funds to the RTC or the institution under its management, and respond to low-income housing needs as appropriate. To accomplish these multiple goals, the Committee established the Real Estate Asset Division ("READ") within the RTC, extended the life of the RTC from five to ten years to help prevent dumping of assets by allowing the RTC additional time for the orderly disposition

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

of such assets and adopted provisions to provide lower income families with access to residential property within the jurisdiction of the RTC.

**142 The Real Estate Asset Division will assure the orderly disposition of real property assets managed by the RTC by exercising primary responsibility over actions of conservators, receivers or managers of institutions with respect to the management, sale or disposal of real property assets. National and regional advisory boards composed of representatives of the real estate and financial professions as well as representatives of low-and moderate-income consumers and small businesses will provide advice on real estate disposition on a local basis. The Committee believes that bringing local market expertise into the decision making process will better ensure that various real estate markets will not be adversely affected as a result of either too many or too few of these assets being put on the market at one time.

*237 The RTC is required to establish guidelines for the management and disposition of real property assets, including guidelines for establishing the market value of assets based upon standard analysis, valuation and appraisal practices. In establishing the market value under this standard, the Committee intends for the RTC to look for the "fair value" of such assets, i.e. the cash price that might reasonably be anticipated in a current sale under all conditions required to achieve fair value as described by Office of the Comptroller of Currency in 12 C.F.R. 7.3025. The principles of the standard are that a buyer and a seller are each acting prudently, knowledgeably, and under no necessity to buy or sell. Fair value is not the value received from a forced or liquidation sale. It represents a price that might be received upon exposure to the open market for a reasonable time, considering the property type and local market conditions.

The Committee believes that the Resolution Trust Corporation must develop a comprehensive and systematic approach to the liquidation of insured insolvent thrift institutions and the subsequent sale of assets held by those thrifts. The net cost to the Corporation, and ultimately to the insurance funds, may be minimized by pooling complementary assets from several different institutions for sale as a single package rather than managing the sale of assets solely on an institution-by-institution basis. Offerings of such packages could be designed to combine and repackage assets of differing investment quality to make them attractive to a broader range of potential purchasers. Similarly, the Corporation should assess the attractiveness of disposing of assets in securitized form and through other innovative structures that could increase the proceeds on the sales.

Section 501 of the Committee bill provides express authority for the Corporation to enter into contracts with non-government entities. Given the enormity of the asset disposition problem, the Committee intends that the Corporation utilize that authority to engage private firms as appropriate to advise or assist it in developing and executing a comprehensive and systematic approach to asset disposition. These firms should have demonstrable and useful expertise and experience in the relevant real estate, securities, financing, or other similar markets.

**143 The Committee expects the Corporation to adopt policies which will preclude any such private advisors from participating in transactions involving institutions or situations in which they have advised or assisted a governmental agency to eliminate the potential for conflict of interest.

The RTC will be the legal successor to the Federal Savings and Loan Insurance Corporation with respect to those institutions that were placed in a conservatorship or receivership after January 1, 1989. The RTC will also be the legal successor to the FSLIC in the Management Agreement dated February 7, 1989, between the FSLIC, the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation.

While the Administration's proposal set forth a basic outline for the RTC, there was no provision for a transition period after enactment. The Committee is concerned that upon the effective date of this legislation, the management of the responsibility for about two *238 hundred institutions will be transferred to the RTC, but the RTC will have no personnel, offices or even telephones. To address this concern, the Committee has provided, in subsection (b) of new section 21A, that the FDIC will act for and on behalf of the RTC until such time as the Oversight Board of the RTC or the FDIC certifies that the RTC has sufficient resources to assume its duties under this Act. The Committee intends that the RTC will be able to assume its duties within 180 days of the bill's enactment. Nothing in subsection (b), however, is intended to preclude other or additional contracts between the RTC and the FDIC. The Committee encourages the RTC to utilize the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

services of the FDIC, on terms agreed to by both parties, for the management and disposition of institutions and assets within the RTC's jurisdiction.

The responsibilities being placed on the FDIC under this bill are extensive, diverse, and difficult. Accordingly, while the bill authorizes the RTC to contract with the FDIC, the RTC must have the capacity and flexibility to accomplish its mission notwithstanding any shortage of resources at the FDIC. The FDIC must not abandon its traditional mission of commercial bank insurance and regulation, since excessive diversion of resources from those tasks would only lay the groundwork for a future crisis in the commercial banking industry.

The RTC will be the legal successor in interest to the FSLIC with regard to functions or activities of the FSLIC that are transferred to the RTC, and as such the RTC will succeed to all of the rights, privileges, titles and interests of the FSLIC in the transferred functions or activities. Thus, for example, the RTC would succeed to the FSLIC's position in contracts for sevices by asset managers, accountants, attorneys, and the like with regard to assets or association which will be under the RTC's jurisdiction. It is not the Committee's intention by abolishing the FSLIC or by confirming the RTC's authority to modify such contracts, that the RTC will automatically terminate current contracts. The Committee believes that many contracts entered into between the FSLIC or the Bank Board and private parties are necessary and will remain in effect. All such contracts will remain, of course, terminable according to their own provisions.

**144 While the Committee did not alter the basic outline for the RTC provided for in the Administration proposal, the Committee did adopt several important amendments designed to increase supervision and oversight of the activities of the RTC. The Committee is concerned that without a significant amount of oversight and control, the RTC could be both costly and cumbersome or be used to further private interest at public expense. The RTC will be charged with managing and disposing of billions of dollars worth of assets of failed institutions. If these assets are not properly dealt with by the RTC, the cost of the resolution of the these institutions to the taxpayer will be increased.

To assure proper oversight, the Committee added several significant safeguards to the Administration's proposal. The RTC will be a wholly-owned government corporation subject to the normal oversight and regular controls of the Government Corporations Control Act including an annual audit by the Comptroller General. In the legislation adopted by the Committee, the RTC will be subject to *239 the Freedom of Information Act, the Privacy Act, and the open meetings provisions and rulemaking provisions of Title 5, United States Code. The bill also provides for a presidentially appointed independent Inspector General for the RTC. The RTC must also submit detailed annual financial reports to Congress that include information as to both the present financial condition of the RTC and future operating plans and commitments.

In addition, the Committee adopted various other reporting requirements for the RTC, including reports on its efforts to include women and minorities in the contracts granted by the RTC, reports regarding the number and kinds of entities contracting with the RTC, and reports detailing the RTC's efforts to utilize the private sector in its asset management and disposition efforts.

The Committee also adopted provisions that would ensure open, unbiased and fair competition for the contracts to be let by the RTC and in any assisted acquisition that the RTC might undertake with respect to an institution under its jurisdiction. The Committee further provided that all agreements for assisted transactions will be subject to public disclosure unless the Oversight Board finds that such disclosure would be contrary to the public interest.

Finally, the Committee adopted provisions that require the RTC, the Oversight Board and the FDIC to utilize the private sector in the management and disposition of assets to the extent that such services are available, practicable and efficient. The Committee intends that the exceptions to the use of the private sector will be applied conservatively. The Committee also expects that the RTC will adopt policies to preclude private advisors from participating in transactions involving institutions or situations in which they have assisted the RTC to eliminate the potential for conflict of interest.

**145 The RTC will be governed by an Oversight Board. The Administration proposed placing the Secretary of Treasury, the Chairperson of the Board of Governors of the Federal Reserve and the Attorney General, or their designees on the Oversight Board. The Committee wanted to include specific expertise and was concerned that these individuals and their respective agencies may not have sufficient experience with the disposition of real property to properly oversee the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

activities of the RTC. Consequently, the Committee added to the Oversight Board the Secretary of the Department of Housing and Urban Development or the Secretary's designee and one member of the private sector experienced in real estate, finance or development activities. The private member will be appointed by the President with the advice and consent of the Senate. The Committee intends that the normal ethical prohibitions regarding participation in a matter in which one has a pecuniary interest will apply to the private sector member. The Committee also added to the membership of the Oversight Board the Chairperson of the Federal Deposit Insurance Corporation; however, to avoid potential conflicts of interest that could arise because the FDIC will be the original manager of the RTC and generally the prime contractor with the RTC the Chairperson of the FDIC will be a nonvoting member of the board.

The Oversight Board has overall responsibility for the operations of the RTC. One specific responsibility of the Oversight Board is to *240 create an outreach program to ensure the inclusion of minorities and women in every phase of the merger and acquisition activities conducted by the RTC. This includes all contracts and agreements entered into for the purchase of assets and assumption of liabilities, consolidations or mergers, or any other transaction by which any person or entity will acquire an institution subject to the provisions of Title V.

The Oversight Board will appoint a Chief Executive Officer for the RTC. This individual will have the day-to-day responsibility for running the RTC and, as provided by the Committee, will be subject to certain employment restrictions for two years after leaving the RTC. The RTC has the power to hire employees and establish a general corporate staff, but cannot hire such employees until the Oversight Board has filed a plan with Congress setting forth its employment, hiring, retention, pay and benefits plans and Congress has not disapproved the plan within 60 days exclusive of any adjournment period longer than three days.

With respect to the assisted transactions undertaken by the Federal Home Loan Bank Board in 1988, subparagraph (f)(a)(5) of Section 21A permits the RTC to review and analyze these agreements and requires the RTC, as permitted by the terms of the agreement and with the concurrence of the RTC Oversight Board, to restructure such resolution agreements if the RTC determines that savings would be realized from such restructuring.

**146 The RTC is also required to wind down or sell the Federal Asset Disposition Association within 180 days after enactment of the bill. It is the intent of the Committee that the employees of FADA be subject to the regular hiring procedures established by the RTC for prospective employees and that no employee of FADA shall automatically become an employee of the RTC when FADA is wound down or sold by the RTC.

In subsection (s), the Committee has included provisions intended to assure that the RTC makes certain residential properties available for lower income families in its property disposition activities. The goal of the Committee is to make suitable RTC assets available as a housing resource for the benefit of lower income families for rental and home ownership purposes and for families, such as first-time home buyers of modest income, who are not being served in the private market.

In restructuring the thrift industry and the depository and regulatory functions of the Federal Government overseeing the industry, the Committee wishes to reaffirm the traditional role of the thrift industry and its institutions as the principal source of mortgage credit for affordable homeownership and rental housing. In acting on this legislation, the Committee believes that the availability of affordable housing of all types must continue to be addressed. The portfolios of many insolvent institutions contain housing stock that the Committee believes should be made available at prices affordable to moderate and lower income families. In the past this Committee has always acted on the basis that within the existing housing stock of this country, there has been housing available for use of low and moderate income households. Lacking the financial and programmatic tools to make this housing asset available for use at affordable levels has been the major obstacle. *241 Subsection (s) of new section 21A will provide a means of making certain housing assets currently held as a result of financial mismanagement and insolvency available as affordable housing for low and moderate income families.

Under subsection (s), before the RTC disposes of certain suitable residential property, it is required to consult with the READ regional advisory boards regarding local housing market conditions. These boards would make an assessment as

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

to the availability of home ownership opportunities for families not traditionally served in the market area, the need for permanent housing for the homeless, the availability and long-term affordability of housing for lower income families and the vacancy rate in the supply of decent and affordable housing for families whose incomes do not exceed 50 percent of the area median income. The RTC must offer to sell such property to qualified nonprofit organizations, State or local public agencies or lower income families for a period of three months prior to offering the properties to other qualified purchasers. The RTC may decide to extend such period beyond three months to any longer period it determines to be reasonable consistent with the purposes of this provision and the intent of the Congress.

**147 The requirement to offer a right of first refusal only applies to a limited segment of the inventory of property owned or controlled by the RTC. It would not apply to any commercial property or any luxury residential property. The properties covered by the requirement would have appraised values that do not exceed $67,500 in the case of a single family home or a range from $28,032 to $58,392 depending upon the bedroom size of a multifamily unit.

In addition, any purchaser of property under a right of first refusal would have to agree that no less than 15 percent of the units purchased would be reserved for occupancy or purchase by and remain affordable to lower income families for the remaining useful life of the property. Not less than 20 percent of the units would have to be reserved for very low incomes families whose income does not exceed 50 percent of the area median. Since the HUD Secretary is on the board of the RTC, it is expected that the lower and very low income limits established by HUD for different areas would be used by the RTC. Affordable housing means housing that can be paid for with 30 percent or less of a family's adjusted income. The fair market rents used in connection with Section 8 of the United States Housing Act of 1937 are not a good measure of affordability and should not be used to meet this requirement. It is possible that some time during the useful life of a building, the housing market could change so substantially that there would no longer be a need for housing for lower and very low income families. Only under these unusual circumstances could the RTC provide a waiver of the lower income occupancy requirements. The expectation is that only organizations committed to providing housing for a very long period to the lower income segment of our population will be eligible to purchase properties made available during the right of first refusal period. These requirements apply equally to units purchased for homeownership purposes and it is expected these requirements will be incorporated in recorded deeds and covenants.

*242 In addition, while there is no prescribed lower income benefit after the right of first refusal period has expired, if the RTC receives substantially similar offers to purchase an eligible property during or after the right of first refusal period, preference must be given to the offer proposing to benefit the highest percentage of lower-income and very low-income families. It is expected that substantially similar offers would not vary as to purchase price.

The Committee is concerned that in its residential property disposition activities, the RTC not adversely impact local real estate markets by undertaking any action that might constitute "dumping" properties on already saturated markets and thereby depressing market values of existing residential properties. In this regard, the Committee believes that to the extent that properties are disposed of by the RTC pursuant to this provision, and to the extent the right of first refusal period is lengthened beyond 90 days, saturation of the private residential real estate market will be reduced. The purpose of subsection (s) is to provide housing for segments of the market—the lower income rental and modest income home-buying market—that are usually excluded or underserved. The sale of properties for these purposes should not compete with new construction efforts and should aid substantially in improving the living conditions of many lower income families.

**148 If the RTC does not receive a bona fide purchase offer for any property during the right of first refusal period established for nonprofit organizations, public agencies or lower income families, the property may be sold to any other entity. A bona fide offer is one that is made in good faith, without deceit, by a State or local government entity or nonprofit organization that is capable of and prepared to honor its purchase offer and the lower income benefits requirements.

The bill requires the RTC to assist in the financing of the sale of residential properties to eligible purchasers in several ways. The RTC is expected to lower the selling price of a property below the net realizable market value to the extent ne-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

cessary to meet the prescribed lower occupancy requirements or the reasonable requirements of first time homebuyers of moderate income. In addition, the RTC is authorized to provide seller financing at rates of interest below its cost of funds to the extent necessary to meet the purposes of this provision. The Committee is aware that both reducing the sales price and providing seller financing are practices currently employed when the Federal Savings and Loan Insurance Corporation disposes of properties held in receivership. Such reductions have been offset and long term yields have been enhanced by reducing the costs of holding these properties in inventory for several years.

In addition, the Committee has authorized the Secretary of HUD to make project based Section 8 assistance available to enable lower income families to rent units in properties purchased under these provisions. The Secretary is further required to expedite the allocation of this assistance for the purposes of this subsection. For assistance under subsection (b)(1) of Section 8 $284,550,000 is authorized for appropriation in 1990, $230,430,000 is authorized for subsection (e)(2) moderate rehabilitation assistance and such sums as may be necessary for both for fiscal year 1991 are also authorized.*243 The Committee wishes to make clear that the Section 8 assistance herein provided is in addition to Section 8 assistance provided for the ongoing programs in such fiscal years. The Congress does not intend to dilute the limited amounts of Section 8 assistance that may be otherwise available to the many needy communities in the nation.

The Committee has similarly authorized the Secretary of Agriculture to provide five-year rental assistance payment contracts, loan guarantees and loan servicing assistance for properties disposed of pursuant to this subsection in rural areas. The Committee authorizes an appropriation of $60 million in fiscal year 1990 and such sums as are necessary for fiscal year 1991, in addition to any amounts otherwise made available for the ongoing low income rural housing assistance programs. The Committee strongly emphasizes that these amounts be provided in addition to the Rental Assistance Payments for which appropriations are made to support the existing Farmers Home Administration rental program and new incremental Section 515 loans approved in annual authorization acts. Currently only about one-half of the approximate 365,000 existing Section 515 units receive Rental Assistance Payments and a significant number of low income tenants who are not receiving such assistance are paying in excess of thirty percent of income toward rent.

**149 The Committee also strongly emphasizes that any guarantees of seller financed loans provided pursuant to subsection (s) shall be in addition to the ceiling established in annual Appropriation Acts for guaranteed and insured loans as provided in annual authorization acts adopted by the Congress.

The Committee believes that the authority to guarantee and to service seller financed loans can go far toward unburdening the RTC from having to service loans in rural areas and to assure a bankable stream of payments to the RTC while minimizing its exposure to inordinate loan servicing costs and to losses from any defaults.

The Committee approved a provision to require the RTC, in consultation with the Secretary of HUD, to explore opportunities to work with secondary mortgage market entities that can assist in financing the disposition of these assets to provide housing for low income families. The Committee acknowledges that secondary market entities are making progress toward developing a secondary market for low income housing, but it is the hope of the Committee that this market can be more fully developed. The Committee believes that the disposition of RTC properties offers a unique opportunity to explore new means to develop this market.

In meeting the objectives of this subsection, the Committee specifically encourages the RTC and the Secretary to examine the usefulness of public/private partnerships and risk-sharing arrangements among mortgage originators, credit intermediaries and federally-chartered secondary market entities. It is also the intent of the Committee that the RTC and the Secretary consult with entities such as mortgage bankers and the Local Initiatives Managed Assets Corporation (LIMAC) and design programs that can be used by companies and nonprofit entities with experience in developing secondary mortgage market products.

*244 The Committee intends, based on existing powers and legal authorities, to encourage cooperation among the Department of Housing and Urban Development, the Federal Housing Administration, the Government National Mortgage Association, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. It is not the intent of the Committee to grant any additional legal authority to these entities to meet the objectives of this subsection.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The Resolution Funding Corporation

The Committee did not alter the Administration's proposal to finance the RTC's activities. The financing mechanism established by the Administration is off-budget and does not count toward the public-debt limit since the obligations to be issued to fund the RTC are not obligations of the United States government.

Under the Administration's plan the RTC will issue nonvoting capital certificates to REFCORP, a new corporation to be chartered by the Director of the Office of Thrift Supervision. REFCORP in turn is authorized to issue up to $50 billion in long-term debt offerings to purchase this capital stock. The REFCORP obligations are not guaranteed as to principal or interest by the United States and the full faith and credit of the United States does not stand behind these obligations. The Treasury is, however, authorized to pay the interest on these obligations to the extent that other sources of funds for these interest payments are insufficient and to the extent that funds are appropriated for that purpose pursuant to the authorization contained in this legislation.

**150 The principal on these obligations will be paid by funds received from the Federal home loan banks and other sources should the bank payments be insufficient. The banks will contribute about $2 billion of their retained earnings. These funds are in addition to any funds that may be required by the Financing Corporation under section 21 of the Federal Home Loan Bank Act. The banks will also annually contribute additional sums for principal and interest payments but the aggregate of such payments shall not exceed the lesser of $300 million or 20 percent of the aggregate net earnings of the Federal home loan banks for each year until the Funding corporation has no more liabilities. The term "net earnings" refers to the net earnings of the previous calendar year. The funds earmarked for principal payments will be used to purchase certain zero-coupon securities which upon maturity will yield an amount sufficient to pay the principal of the REFCORP notes. If the payments from the home loan banks have been exhausted and additional funds are needed, Savings Association Insurance Fund members can be required to contribute a portion of their insurance premiums, and finally, certain receivership proceeds can be used to makeup any remaining shortfall.

The Committee understands that the term "receivership proceeds" as used throughout section 502 includes the amounts received as liquidating dividends by the FSLIC Resolution Fund as successor to the Federal Savings and Loan Insurance Corporation as subrogee of the insured accountholders of the institution in receivership.

*245 The Committee approved a provision to provide small investors the opportunity to participate in public offerings of Resolution Funding Corporation obligations. Since the American taxpayer is being asked to pay for a substantial portion of the savings and loan bailout, the Committee is making a portion of REFCORP bonds available in minimum $1,000 denominations to enable a wider range of taxpayers to share in the benefits of these bonds.

Because the Committee is uncertain about the demand among small investors for small denomination REFCORP bonds, the Funding Corporation is authorized to offer the portion of bonds in small denominations that it deems appropriate. However, it is the intent of the Committee that the Funding Corporation make every effort to offer the bonds in a portion equivalent to small investor demand for the bonds.

It is the intent of the Committee that the Funding Corporation make its small denomination obligations as broadly available to the general public as possible. At a minimum, the Funding Corporation will make its small denomination obligations available for purchase through the Federal Reserve banks and branches. Since there are only a limited number of Federal Reserve bank and branch locations, it is the intent of the Committee that the Funding Corporation explore additional alternatives to make its obligations more broadly available to the public. The Committee also intends that the Funding Corporation develop mechanisms to broadly advertise the availability of its small denomination obligations, possibly through United States post offices or Federally insured financial institutions.

TITLE VI—THRIFT ACQUISITION ENHANCEMENT PROVISIONS

**151 Title VI contains amendments to the provisions of section 10 of the Home Owners' Loan Act concerning savings and loan holding companies and to section 4 of the Bank Holding Company Act. Generally, the purpose of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

amendments is to attract private capital to the thrift industry.

Section 601

Section 601 permits bank holding companies to acquire savings associations immediately upon enactment of the FIRRE Act. The Committee deleted the two year delay on acquisitions of healthy thrifts contained in the legislation as introduced. The Committee believes that the infusion of private capital into the thrift industry must proceed as quickly as possible.

The acquisitions must be made under section 4(c)(8) of the Bank Holding Company Act, subject to all of the requirements and restrictions applicable under that section. Section 601 does not authorize a bank holding company to engage in any activity that otherwise would be impermissible under section 4(c)(8).

Section 601 directs the Federal Reserve Board to no longer impose its so-called "tandem operations" restrictions on bank holding companies that acquire or have acquired thrift institutions. However, this provision does not affect the applicability of section 4 to such acquisitions.

*246 Section 602

Section 602 amends the provision of current law that prohibits savings and loan holding companies from acquiring any voting shares of a non-subsidiary savings associations or savings and loan holding company without prior regulatory approval. The revised treatment is intended to mirror the ability of bank holding companies to acquire up to 5 percent of the voting shares of unaffiliated banks without prior approval. The amendment permits savings and loan holding companies to acquire up to 5 percent of the voting shares of a non-subsidiary savings association or savings and loan holding company without prior approval, and it exempts the following acquisitions from the 5 percent limitation:

(1) Purchases of shares in connection with a qualified stock issuance under section 10(q)(1)(D) of the Home Owners' Loan Act, as added by Section 604 of the bill.

(2) Passive investments by thrift-affiliated insurance companies in savings and loan holding companies described in section 10(c)(3) of the Home Owners' Loan Act (formerly section 408(c)(3) of the National Housing Act). However, such investments may not be made or retained with a view to acquiring, exercising or transferring control of the issuer of the shares.

(3) Acquisitions in connection with an underwriting in the normal course of business or in an account established solely for trading purposes.

(4) Holdings as a bona fide fiduciary.

(5) Acquisitions of shares made in securing or collecting a debt previously contracted in good faith, until two years after the acquisition or for such additional time (not exceeding three years) as the Director of the Office of Thrift Supervision permits if he judges an extension not to be detrimental to the public interest.

**152 (6) Control of voting rights acquired in the normal course of a proxy solicitation.

Similar exemptions are found in the Bank Holding Company Act.

These exemptions apply only to the limitation on the acquisition of 5 percent or more of voting shares. The separate prohibition under current law against a savings and loan holding company acquiring control of a non-subsidiary savings and loan holding company or thrift without prior approval continues to apply, whether control results from an acquisition of shares under any of the exempted circumstances or from any other circumstances.

Section 603

Section 603(a) makes a technical amendment to conform references to the term "insured institution" in the Bank Holding Company Act to the term now used in section 10 of the Home Owners' Loan Act, the successor to section 408 of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

National Housing Act. State savings banks will have the same status for purposes of the Bank Holding Company Act as they do currently.

Section 603(b) amends section 4(f)(2)(A)(ii) of the Bank Holding Company Act, which conditions the grandfathered status of certain companies on their not acquiring, directly or indirectly, more than *247 5 percent of the shares or assets of an additional bank or savings association with certain exceptions. Section 603(b) amends the exceptions as follows:

(1) It provides that for purposes of section (4)(2)(A)(ii), shares held solely for the benefit of employees (including former employees) of a grandfathered company or any of its subsidiaries and for the benefit of beneficiaries of such employees are not for that reason to be considered to be controlled by the grandfathered company. The Committee believes that this clarification is important in order to avoid the administrative problems encountered by grandfathered companies which have diverse employee benefit plans.

(2) It provides that shares over which no control is held other than control of voting rights acquired in the normal course of a proxy solicitation are exempted from the section 4(f)(2)(A)(ii) restriction.

(3) It provides that section 4(f)(2)(A)(ii) does not apply to shares or assets acquired in securing or collecting a debt previously contracted in good faith until, in the case of shares, two years after the acquisition or such additional time (not exceeding three years) as the Federal Reserve Board may permit if it judges an extension not to be detrimental to the public interest. The exemptions added by section 603(b) apply only to the restriction on the acquisition of 5 percent or more of voting shares. The separate prohibition under current law preventing the acquisition of control of an additional bank or savings association continues to apply, whether control results from an acquisition of shares under any of the exempted circumstances or from any other circumstances.

Section 604—The Thrift Early Capital Attraction Plan

Section 604 incorporates into the legislation H.R. 949, the Thrift Early Capital Attraction Plan, originally introduced by Congressman LaFalce. It is the view of the Committee that the provision would benefit a number of weakly-capitalized, but solvent, savings institutions. Many of these institutions will fail, increasing the ultimate loss to the insurance fund, unless they can attract additional capital. Section 604 is intended to help attract capital to undercapitalized savings associations—those that have a capital to assets ratio of less than 5 percent but that are still solvent—by doing the following:

**153 Amending section 10(e) of the Home Owners' Loan Act (formerly section 408(e) of the National Housing Act) to authorize savings and loan holding companies to make direct equity investments in newly issued stock representing up to 25 percent of the total outstanding stock of the undercapitalized savings association (or holding company which controls the undercapitalized savings association).

Requiring that the Director of the Office of Thrift Supervision approve each acquisition.

Requiring that the funds be maintained as part of the capital of the undercapitalized savings association or holding company.

*248 Requiring that the shares issued be previously unissued stock or treasury shares. In no case could the investing holding company purchase shares held by existing stockholders. Thus the undercapitalized thrift or holding company would have to agree to the dilution voluntarily.

Requiring that the investing holding company's savings association subsidiary or subsidiaries has a capital to assets ratio of not less than 6 1/2 percent. The investing holding company and the undercapitalized savings association or holding company must meet the financial and managerial resources and community benefits standards established by the Director and the investment must be disapproved if it is determined to have significant anti-competitive effects, unless such effects clearly are outweighed by the public benefits of the investment.

Amending the Bank Holding Company Act to permit certain grandfathered companies to purchase shares in connection with a qualified stock issuance and to engage in other assistance transactions with troubled institutions without becom-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ing a bank holding company for purposes of that act.

It is the Committee's hope that the Thrift Early Capital Attraction Plan will cause—

New capital to come into the industry,

Capital investors, who have an incentive to protect their investment, to perform oversight functions that ultimately protect the deposit insurance fund, and

Deteriorating institutions to be addressed before they require Federal assistance.

TITLE VII—FEDERAL HOME LOAN BANK SYSTEM REFORMS

Title VII of the Committee bill abolishes the current Federal Home Loan Bank Board by clearly separating the regulatory/supervisory function from the credit functions. The title creates a sound regulatory/supervisory structure with clear lines of authority and accountability and at the same time renews the Federal home loan banks' role as supporters of housing.

The regulation, supervision and examination responsibilities for Federally chartered thrift institutions would be placed in a newly created Office of Thrift Supervision within the Department of the Treasury—similar to the Office of the Comptroller of the Currency, the regulator for national banks. The Office of Thrift Supervision would be headed by a Director of Thrift Supervision appointed by the President and confirmed by the Senate.

**154 The credit mechanism (the cash advance program) and the promotion of housing finance are placed under a newly created independent executive agency, the Federal Housing Finance Board, which shall supervise the 12 existing Federal home loan banks. The Federal Housing Finance Board is composed of seven members; the Secretary of Housing and Urban Development, two presidents of the Federal home loan banks and four members appointed by the President with the advice and consent of the Senate.

The Federal home loan banks will continue to administer the cash advance programs—borrowings by member institutions. The banks will no longer be assigned supervision or enforcement responsibilities.*249 These functions will be administered by the Office of Thrift Supervision.

In addition to the general advance program currently operated by the district banks, the title requires the establishment of two special purpose programs to target advances for low and moderate income housing and community investment needs.

Background

The Federal Home Loan Bank Act of 1932 established the Federal Home Loan Bank System to promote housing through the extension of credit to the thrift industry. The individual Federal home loan district banks also established under this Act serve as a source of below-market loans for the thrift industry. The district banks, in which member thrift institutions own stock, were established with the primary mission of channeling money into the housing finance industry. The banks accomplish this by making loans to individual thrift institutions at interest rates lower than those in the capital market, particularly longer-term funds. This practice allows member savings institutions to use the funds to make loans to home buyers or to meet temporary liquidity needs.

Presently, in addition to providing credit, the district banks are assigned the responsibility of carrying out the supervision and examination functions of thrift institutions. The district bank presidents serve as the principal supervisory agents with authority on such matters as deciding applications from member institutions and enforcing federal law and regulation.

The restructuring provided by the bill eliminates the dual role and the conflicts inherent in the present structure. Under present law, the Federal home loan banks supervise the institutions which own stock in the banks and elect each bank's Board of Directors.

In addition to the clear conflict in the basic structure, there have been occasions when the regulatory authority of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

individual Federal home loan banks has been placed in conflict with the separate regulatory authority asserted by the Washington-based Federal Home Loan Bank Board. The Committee believes that a clear separation of the credit and supervisory functions—with clear accountability—is better public policy.

Office of Thrift Supervision

Upon terminating the Federal Home Loan Bank Board, the bill establishes an Office of Thrift Supervision as a bureau in the Department of the Treasury, to be the chief regulatory agency of the thrift industry.

**155 The power and authority to prescribe regulations, and orders necessary for carrying out the duties of the Office of Thrift Supervision, and all powers the Federal Home Loan Bank Board prior to the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 that are not transferred to another agency pursuant to this Act, will be vested in the Director of the Office of Thrift Supervision. The Director, who shall be appointed by the President, by and with the advice and consent of the Senate, will serve a term of 5 years. The Director is prohibited from having a financial interest, either directly or indirectly, in any member of a Federal home loan bank. Individuals who serve as members of *250 the Federal Home Loan Bank Board, before enactment of this Act will not serve in the capacity of Director unless nominated by the President and confirmed by the Senate.

The Director shall have the power to select, employ and establish the compensation of such officers, employees and agents as necessary to carry out the Director's duties. When fixing compensation levels, the Director will seek to maintain comparability with compensation at the other federal bank regulatory agencies.

Examiners appointed by the Director shall be subject to the same requirements, responsibilities, and penalties as are applicable to examiners under the National Bank Act and the Federal Reserve Act, and will have the same powers and privileges.

Federal Housing Finance Board

The legislation transfers authority of the Federal Home Loan Bank Board to supervise the Federal home loan banks to the Federal Housing Finance Board. The Federal Housing Finance Board is established as an independent agency in the Executive branch of the Federal government. The Federal Housing Finance Board is vested with such powers, expressed and implied authorities, and purposes provided in the Federal Home Loan Bank Act, as amended.

As an independent agency in the Executive Branch, the Federal Housing Finance Board shall be subject to the Administrative Procedure Act, the Freedom of Information Act and the Government In The Sunshine Act.

The Federal home loan banks may engage in all activities authorized in the Federal Home Loan Bank Act. Notwithstanding the authority to engage in corresponding banking activities, the principal function of the Federal home loan banks is to promote economical housing finance by serving as lending facilities for their member institutions.

The Treasury Department's oversight and direction of the Director of the Office of Thrift Supervision shall not extend, directly or indirectly, to the Federal Housing Finance Board or to any office or joint office of a Federal home loan bank to the extent that it is engaged in credit-related or correspondent banking activities. Nevertheless, the Treasury Department's oversight of the Director of the Office of Thrift Supervision would extend to any regulatory functions delegated by the Office of Thrift Supervision to any individual or office of a Federal home loan bank.

Board of directors

**156 The Board of Directors of the Federal Housing Finance Board shall have seven members, consisting of the Secretary of Housing and Urban Development, the presidents of two of the Federal home loan banks, and four citizens of the United States to be appointed by the President, by and with the advice and consent of the Senate. Each Federal home loan bank president on the Federal Housing Finance Board of Directors shall be elected by vote of the presidents of all of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Federal home loan banks, utilizing such procedures as the presidents will determine. Each president so elected shall serve as a member of the Board of Directors for a term of two years.

*251 Each appointive member shall hold office for a term of seven years. Not more than two of the appointive members may be members of the same political party, and not more than one such member may be appointed from any single Federal home loan bank district. At least two of the appointive members shall be representatives chosen from organizations with more than a two-year history of representing consumers or community interests on banking services, credit needs, housing matters or financial consumer protection. No appointive member of the Board of Directors of the Federal Housing Finance Board may, during such member's term of office, be an officer or director of any Federal home loan bank or a stockholder, officer, or director of any member of a Federal home loan bank. Although members of the Board of Directors will not serve on a full-time basis, no appointive member of the Federal Housing Finance Board may hold any other federally appointive office. In addition, the Committee intends that the Federal Housing Finance Board be a small, effective and efficient governing body.

The Board of Directors of the Federal Housing Finance Board shall supervise the Federal home loan banks, will perform other duties specifically prescribed by the Federal Home Loan Bank Act, and shall have the power to adopt, amend, and require the observance of such rules, regulations, and orders as may be necessary from time to time to carry out the purposes of the Federal Home Loan Bank Act. The Board of Directors shall have the power to select, employ and establish the compensation of such officers, employees and agents as may be necessary for the performance of its duties.

The Board of Directors may fix compensation of such officers, employees and agents without regard to provisions of laws applicable to officers or employees of the United States. No employees may be transferred from the Federal Home Loan Bank Board or the Federal Savings and Loan Insurance Corporation to the Federal Housing Finance Board without the approval of the Board of Directors of the Federal Housing Finance Board. The Board of Directors will have the power to suspend or remove for cause any director, officer, employee or agent of any Federal home loan bank. The cause of any such suspension or removal must be communicated in writing, in a timely fashion, to that director, officer, employee or agent, as well as to the Federal home loan bank.

Administrative expenses

**157 The Federal Housing Finance Board shall have the power to levy semiannually upon the Federal home loan banks an assessment sufficient to provide for the payment of the estimated expenses of the Federal Housing Finance Board for the following six months. The assessment will be allocated among the Federal home loan banks on an equitable basis, as determined by the Federal Housing Finance Board. Any surplus from such assessment at the conclusion of any semiannual period will be deducted from the assessment for the following semiannual period. Because of the separation of the regulatory and credit functions of the current Federal home loan bank system, neither the Federal Housing Finance Board nor any of the Federal home loan banks shall be subject to any assessment for the operation of the Office of Thrift Supervision*252 or any of the regulatory functions performed by, or under the supervision of, the Office of Thrift Supervision.

Federal Home Loan Bank membership and access to general advances

The Federal home loan banks, which were established under the Act as federally chartered, serve as the primary lending facility for all member savings institutions. The Committee determined that in order to promote and sustain housing finance, membership in the Federal home loan banks should be extended to include insured commercial banks and credit unions that engage in mortgage lending. The Committee believes the provision will strengthen the Federal home loan banks and their ability to support the mortgage market.

In order to gain full access to a Federal home loan bank's regular advances, each prospective member must meet the qualified thrift lender test. For those institutions that do not meet the qualified thrift lender test, access to Federal home

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

loan bank advances can be obtained on a basis proportional to that institution's demonstrated commitment to housing.

In order to obtain access to the advance program, insured commercial banks and credit unions must, like savings associations, purchase stock in the Federal home loan banks based on policies and procedures established by the respective district banks. The minimum amount of stock purchases must be the greater of 1% of the member's mortgage amounts or 5% of the Federal home loan bank advances to the member.

The cash advance program and housing

The Federal home loan bank system became an essential lifeline for the savings and loan industry after its creation in 1932. As instrumentalities of the Federal government, and backed by a $4 billion line of credit from the U.S. Treasury, the Federal home loan banks are able to raise funds in the capital markets at preferred rates and pass on subsidized cash advances to member institutions. At year-end 1988, these subsidized advances to savings and loans totaled more than $153 billion.

The public policy rationale for creation and maintenance of a subsidized cash advance facility for the industry has always hinged on support for mortgage lending. Both the Federal home loan banks and the industry have paid homage to this rationale through the years.

**158 In recent years, serious questions have been raised as to whether the cash advance program is truly living up to its primary role. A 1988 study by the General Accounting Office found that savings and loans receiving cash advances showed no greater commitment to mortgage lending than did those that shunned the advance windows.

At year-end 1986, the 1,701 savings and loans that used cash advances held an average of 47.4 percent of their total assets in one-to-four family mortgage loans while the 1,519 savings and loans without cash advances held an average 48.22 percent of their total assets in one-to-four family mortgage loans. In fact, the savings associations which borrowed from the Federal home loan banks*253 showed a greater predilection for such non-mortgage activities as acquisition and development loans, commercial loans and direct investments.

To reestablish, reinforce and target the Federal home loan banks' statutory purpose as supporters of the mortgage market, the Committee adopted an amendment to provide a new structure for the advance mechanisms or "windows" and a new focus on today's housing credit needs.

The amendment requires the Federal Housing Finance Board to adopt regulations establishing minimum community lending standards that must be met by institutions seeking to borrow from the general cash advance window.

In addition to the general advance window, the bill establishes two special purpose windows to target advances for low and moderate income housing and community investment needs.

The special purpose windows would support:

(1) A Community Investment Program.—This provision is designed to strengthen and establish a structure for the Community Investment Funds (CIF's) already operated by a majority of the Federal home loan banks. This program would provide financing at the banks' cost of funds plus administrative expenses; and

(2) An Affordable Housing Program.—Under this program, the banks would make advances at below-market rates to member institutions that, in turn, would re-lend at below-market rates for low and moderate income housing.

The Committee believes that the lending generated by advances from both the Community Investment and the Affordable Housing windows will serve as a catalyst to pull together private and public resources in local communities. In many cases, the advances will make possible loans that, combined with other funds from nonprofit housing organizations, foundations and local governments, can make community development and housing efforts work.

The Community Investment Program

In 1978, the Federal Home Loan Bank Board, under the urging of President Carter, established a Community Investment Program in the Federal home loan banks. Under this Program the banks made advances available to member institu-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

tions that maintained strong community investment records. These special cash advances were priced 50 basis points below the system's cost of funds. During the five-year period from 1978 to 1983, a cumulative total of $7.9 billion in cash advances were extended under the program. The centralized program was terminated in 1983, but 10 of the 12 banks have since adopted separate Community Investment Fund (CIF) programs. Most of the current programs are very modest, with stronger efforts concentrated in a few districts. Unlike the below-market-rate program initiated in 1978, the current CIF programs are at cost-of-funds plus administrative charges, typically 10 to 15 basis points.

**159 The Community Investment Program, while lacking the below-market aspect of the Affordable Housing advance window, can serve as an important mechanism to encourage financing for non-*254 standardized low and moderate income mortgages that do\ not have ready access to secondary markets.

Depository institutions are increasingly reluctant to make loans that cannot be sold easily in the secondary market. Examples of such loans include permanent mortgage loans for multifamily dwellings, mixed-use buildings, rehabilitation loans for one-to-four family dwellings and conventional one-to-four family mortgage loans where private mortgage insurance cannot be obtained. The availability of advances from the Community Investment window could help close the market gap for these and similar loans with nonstandardized terms and underwriting characteristics.

To be workable, it is essential that the Community Investment window include long-term advances that can match long-term fixed rate mortgage lending by member institutions. Non-profit organizations and others involved in low and moderate income housing efforts are poorly equipped to absorb the future shocks that often accompany flexible rate, shorter-term funding. Without long-term advances, member institutions will be slow to provide the long-term fixed rate mortgages necessary to make many of these projects workable. The Federal home loan banks should take affirmative steps to work with member institutions to develop advances with maturities matching the real world of funding for low and moderate income housing efforts.

The Committee recognizes that several of the Federal home loan banks have launched substantive efforts to revive the Community Investment efforts that lay dormant in the mid–1980's. The Committee, however, believes all the banks are in a position to do much more with their CIF programs. Since funding for this aspect of the program is at cost plus administrative expenses, the banks should be able to affirmatively market and expand the Community Investment Program.

Affordable Housing Program

The Affordable Housing Program is intended to support the origination of low and moderate income housing loans by member institutions at below-market interest rates.

Under the Affordable Housing Program, each Federal home loan bank must provide subsidized advances to members that will use these funds to provide subsidized long-term loans for affordable low and moderate income housing.

The funds for the subsidy are provided by the banks calculated on a pro-rata basis according to the amount of aggregate advances outstanding at any given calendar year end. During each of the first four years of operation of the program, the banks would be required to set aside an amount equivalent to .05 percent of the aggregate outstanding advances as of December 31 of the prior year, or no less than $75 million. In the fifth year, the set-aside is an amount equivalent to .06 percent of the prior year's aggregate outstanding advances, or no less than $90 million. In each of the subsequent years the contribution is an amount equivalent to .1 percent of the aggregate outstanding advances as of December 31 of the prior year, but not less than $150 million.

**160 The below-market interest rate on the advances will allow member institutions to reduce the interest rate on mortgages for*255 low and moderate income housing. How far the below-market rate advances will stretch depends, of course, on the degree of subsidy provided on each advance. If the overall average subsidy is 200 basis points, $75 million of below-market advances would generate $3.75 billion of low and moderate income housing. Advances of $150 million, using an average subsidy figure of 200 basis points, would generate $7.5 billion of low and moderate income housing.

The appropriate level of subsidy will vary from project to project. Nonprofit housing organizations have informed the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Committee that even a 200 basis point subsidy—particularly when combined with other sources of funding—would be "enormously helpful" in low income housing efforts.

For example, Daniel Leibsohn, President of The Low Income Housing Fund of San Francisco, told the Committee:

> Our activities, which are all focused on very low income households including homeless people, have been directed toward conventional lenders, to a great extent, in order to increase access to capital for low income communities. The developments we work with use a large number of sources of financing and subsidy. Their feasibility requires extensive equity, usually in the form of subsidy, long-term deferred loans, or syndication. A reduction in conventional rates—even 2%—would play an important role in enhancing their feasibility, reducing the amount of necessary equity, and increasing the possible loan amount. These developments rely on a variety of sources to make them feasible and an improvement in any one of them—such as in the rate on permanent financing—is extremely helpful.

While the Committee recognizes the need for flexibility in establishing the appropriate levels of subsidy, guidelines should be developed and published to avoid ad hoc decisions that could lead to inequities. The guidelines and the level of subsidy must be consistent with the banks' requirement to provide priority for the projects targeted to specific needs of low and moderate income families.

The bill requires that each bank give priority to housing sponsored by nonprofit organizations, state or political subdivision of any state, local housing authorities and state housing finance agencies. It also provides a priority for the purchase or rehabilitation of housing held by the U.S. government. Another priority is funding for the purchase, rehabilitation or construction of multifamily rental housing. The eligibility for this priority includes a requirement that at least 40 percent of the units of such a project must be occupied by low or moderate income families for not less than thirty years. It is the intent of the Committee that priority projects be funded before nonpriority low and moderate income projects.

The Committee expects the Federal Housing Finance Board to adopt regulations that spell out eligibility requirements in keeping with the enumerated priorities and the definitions provided in this section concerning low and moderate income households, and neighborhoods and affordable rental housing.

**161 If there are unused subsidy funds due to a lack of applications for eligible projects at any bank, the excess above 10 percent must be placed in an Affordable Housing Reserve Fund to be administered*256 by the Board. The same eligibility and other guidelines that apply to the Affordable Housing Program would apply to this Fund.

The Board is authorized to provide funds from this central reserve fund to the Federal home loan banks that have fully utilized their own contributions for the purpose of supporting additional cash advance lending under the program. This central reserve fund has a two-fold purpose: to provide an incentive for individual banks to utilize their required contributions; and to generate additional funds for banks with extensive program activity.

Community Investment Officer

The legislation requires each bank to designate a Community Investment Officer who will have operational responsibility for the Affordable Housing and Community Investment windows. It is the intent of the Committee that the Community Investment Officer be a senior official who would report directly to the President of the bank. A prime function of the Community Investment Officer will be to develop an outreach program to promote the utilization of the special purpose windows.

Advisory Councils

Each bank is required to establish an Advisory Council whose members must be drawn from community and nonprofit organizations actively involved in providing or promoting low and moderate income housing in the bank's district. The Council will meet at least quarterly with the Board of Directors of the bank to advise the bank of low and moderate income housing programs and needs in the district. The Council also must monitor the advance programs of the bank and make recommendations to the bank concerning the operation of the programs. Each bank is to provide the Council with

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

the timely data necessary to carry out these functions. The Council must submit an annual analysis of the bank's low-income housing efforts. Each Council's analysis must be included in the Federal Housing Finance Board's annual report to Congress.

Oversight functions

The General Accounting Office is given specific authority to audit the Federal home loan banks. The Committee intends the responsibility of the GAO to encompass audits of the performance of the banks in carrying out the public purposes of the cash advance windows. The Federal Housing Finance Board is given the responsibility to supervise the Federal home loan banks. This supervision is to cover the banks' adherence to the public purposes provided in the Act, including the cash advance windows. In addition, the Board is to submit a report annually to the Congress detailing the banks' support for low and moderate income housing.

Federal Home Loan Bank directors

The Committee, with the intent of giving the housing community a voice in the allocation of credit to that community, has modified the composition of the Board of Directors of the Federal home loan banks. The process of electing directors shall remain unchanged; ***257** however, at least two appointed members of the Board of Directors of each Federal home loan bank must be representatives chosen from organizations with more than a two-year history of representing consumer and community interests on banking services, credit needs, housing matters, or financial consumer financial protection.

****162** In addition, no appointive member may, during such member's term of office, be an officer or director of any Federal home loan bank or a stockholder, officer or director of any member of a Federal home loan bank.

District bank loans for the Savings Association Insurance Fund

The legislation as originally proposed would have required the Federal home loan banks to make loans to the Federal Deposit Insurance Corporation for use of the Savings Association Insurance Fund, at the direction of the Federal Deposit Insurance Corporation. The original legislation, however, did not specifically state that such loans be adequately secured or that the interest rate on such advances be payable at the Federal home loan bank's current marginal cost of funds. The Committee's bill rectifies these omissions. As is the case with all advances by the Federal home loan banks, loans for the Savings Association Insurance Fund must be adequately secured as determined by the Federal Housing Finance Board and the Federal home loan bank. In addition, the interest on such advances shall be no less than the Federal home loan bank's current marginal cost of funds.

Notwithstanding the separation of the regulatory and credit functions, and the independence of the Federal Housing Finance Board, the legislation recognizes some continuing responsibility of the Federal home loan banks to assist in providing needed short-term liquidity to their member savings associations. Thus, upon the certification of the Director of the Office of Thrift Supervision that a particular savings association represents a supervisory concern due to its poor financial condition, but is solvent and that has a reasonable and demonstrable prospect of returning to a satisfactory financial condition, the Federal home loan bank of which that institution is a member may make advances to that savings association on terms and conditions substantially the same as those for similar liquidity advances made available to other savings associations. Comparable terms and conditions include interest rates and requirements for adequate collateral security.

The comparability is to be determined based upon short-term liquidity advances made to savings associations and not to the terms which are applicable to long-term lending programs or special lending programs, such as those contemplated under the Community Investment Fund Program and the Affordable Housing Fund Program. In order to insure that any such advances are consistent with the principles of prudent lending and that Federal home loan banks are not asked to

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

make unsafe or unsound advances, the determination that an institution has "reasonable and demonstrable" prospects of returning to a satisfactory financial condition shall be determined pursuant to regulations promulgated by the Federal Housing Finance Board.

The Committee emphasizes that this is merely a clarifying amendment because of the separation of the regulatory and credit*258 functions. No change is intended in the underwriting standards of the Federal home loan banks and the amendment is not intended to change the function of the Federal home loan banks from housing lenders to lenders of last resort.

**163 In addition, the Federal Housing Finance Board shall, upon the certification of the Director of the Office of Thrift Supervision that severe financial conditions exist in any community or region that threaten the stability of a significant number of savings associations in that community or region, consult with the Director of the Office of Thrift Supervision and establish credit policies, procedures and standards that shall maximize the availability of advances to such savings associations consistent with the safety and soundness of the Federal home loan bank, principles of prudent lending (including interest rates and adequate collateral requirements) and the public interest.

In this regard, to operate safely, soundly and profitably, the Federal home loan banks may make only fully collateralized advances, considering all appropriate lending risks, including credit, interest rate, and liquidity risks.

Required study: Transfer of jurisdiction

The Secretary of the Treasury is required to conduct a study of the anticipated benefits of transferring institutions that are members of one Federal home loan bank to another with emphasis placed on the potential benefits of transferring savings and loans in Maryland from the 3rd District to the 4th District. The Secretary of the Treasury would be required to take into consideration the importance of apportioning districts with due regard for the convenience and customary course of business of the eligible institutions in each district. The Secretary of the Treasury shall report such findings, no later than 6 months after the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, to the Senate Committee on Banking, Housing and Urban Affairs, and the House Committee on Banking, Finance and Urban Affairs and make recommendations with respect to the anticipated benefits of transferring supervision of the savings and loan institutions in Maryland, as well as institutions in other states. It should be noted that the purpose of the study is to consider the potential benefits of the realignment of districts and not the elimination of any of the twelve regional banks.

Section 725 requires the General Accounting Office to conduct a study of the risks undertaken by and the appropriate level of capital consistent with: (1) the financial soundness and stability of government-sponsored enterprises and (2) minimizing any potential financial exposure of the Federal government. The Comptroller General must submit to the Congress, not later than May 1, 1990, a report containing the results of the study and recommendations for appropriate capital standards for each government-sponsored enterprise. It is not the intent of the Committee that this study and report alter in any way the precedents of the House regarding the jurisdiction over the government-sponsored enterprises named in the report. The Committee recognizes the jurisdiction of the Committee on Agriculture and the Committee on Education and Labor*259 and expects to work with those committees on any legislation which affects subjects within the jurisdiction of these committees.

TITLE VIII—BANK CONSERVATION ACT AMENDMENTS

**164 This title amends various provisions of the Bank Conservation Act. Section 802 gives the Comptroller exclusive authority to appoint either the FDIC or another person as conservator for a bank and sets out a number of conditions under which the Comptroller may make such an appointment. These conditions are similar to the grounds for appointment of a conservator or receiver for Federal savings and loan associations under current law. These circumstances generally exist in troubled banks, i.e., banks that are in an unstable condition as a result of mismanagement, insider abuse, or a

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

downturn in the segment of the economy in which the bank is most involved. Under prior law there were no explicit standards for appointing a conservator. To provide a measure of the flexibility, the section would also authorize the Comptroller to identify other circumstances in which the appointment of a conservator is justified. The Comptroller could use a conservator to return an unstable bank to stability or, at a minimum, maintain the status quo to provide a more saleable bank.

The current provisions regarding the appointment of a conservator do not address judicial review. Consequently, the Committee adopted provisions that would permit, in accordance with other statutes authorizing the appointment of a conservator by Federal financial regulatory agencies, an affected bank to bring an action within 10 days of the appointment. Judicial review, however, would not be available in cases where the bank has consented to the imposition of a conservator or where its insurance has been terminated (an action that already provides adequate administrative and judicial review).

Section 803 deleted an existing provision authorizing the Comptroller to conduct such examinations as are necessary to inform the Comptroller of the condition of the bank. This provision is no longer necessary. Because a bank under conservatorship remains a national bank, the Comptroller may continue to conduct such examinations pursuant to the general examination authority provided in 12 U.S.C. 481. Section 803 requires the Comptroller to consult with the FDIC when examining and supervising an ongoing bank for which the FDIC has been appointed conservator.

The interpleader provision of section 804 is included as a protection for the shareholders and nondepositor claimants because they are otherwise precluded from suing the conservator for actions taken (except where gross negligence can be shown).

Under current law, the powers of a conservator are unclear. Section 805 resolves this situation by stating that the conservator will be given the authority and responsibility of the shareholders, officers and board of directors. It is anticipated that regulations will be written regarding the specific powers and duties of the conservator. The provisions of this section that provide that the Comptroller shall be subject to the laws applicable to officers, directors and employees of a national bank are intended to establish that the conservator has sufficient flexibility and authority to operate the bank**260 in an attempt to restore it to a stable and/or profitable operation and to give the conservator the authority to sell the bank.

**165 Under section 806, the conservator would be protected from personal liability for actions taken as conservator except for those actions which are grossly negligent. Because the conservator would be making difficult decisions regarding a troubled bank, proof of "gross negligence" would require that the conservator's decision was an extreme and obvious departure from prudent banking practices resulting in significant damage to the bank.

TITLE IX—REGULATORY ENFORCEMENT AUTHORITY AND CRIMINAL ENHANCEMENTS ("ENHANCED ENFORCEMENT POWERS ACT OF 1989")

General discussion

The Committee believes enactment of Title IX is absolutely essential to respond to a serious epidemic of financial institution insider abuse and criminal misconduct and to prevent its recurrence in the future. Without enactment of this title, as now reported, the U.S. Government will continue to lose the battle against such misfeasance and malfeasance.

While economic uncertainty and depressed conditions in certain locations and in certain industries have contributed to the large number of financial institution failures, the Committee believes, as did an October 1988 House Government Operations Committee report on the subject,[1] that misconduct, fraud, and abuse have significantly contributed to or caused hundreds of bank and thrift failures and the consequent multi-billion dollar losses facing the U.S. Government. Evidence developed by the House of Representatives indicates that serious misconduct by insiders and affiliated borrowers has caused or contributed to the insolvencies of at least one-third (and probably more) of all failed commercial banks and over three-quarters of all failed S & Ls, with tremendous costs to the FSLIC and the FDIC. In June 1988, the Comptroller of the Currency issued a study which found that inept or corrupt management was more frequently the cause of

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

national bank failures than depressed economic conditions, contradicting a widely held view.

The Committee heard evidence of a tremendous backlog in pending criminal investigations. According to the March 22, 1989, testimony of Acting Associate Attorney General Whitley and the October 1988 House Government Operations Committee report, the number of financial institution criminal misconduct cases has overloaded the criminal justice system. That House report concluded:

19. a. Pending bank fraud investigations are overwhelming the Federal criminal justice system. There are acute shortages of sufficiently compensated and experienced prosecutors and investigators in most areas of the Nation to handle these more complex cases.

b. Timely investigations and/or prosecutions of many of the 3,340 pending FBI investigations involving losses of $100,000 or more is highly improbable, if not impossible, *261 without a substantial increase in the Justice Department's static budget.

c. The lack of eventual prosecutions and the imposition of often lenient sentences together constitute the greatest single impediment to deterring criminal behavior in the banking and thrift industry.[2]

**166 The genesis for Title IX derived from a 1984 report by the House Committee on Government Operations which pointed out serious gaps in the banking agencies' civil enforcement authority and which recommended industry-wide removal/prohibition orders, expanded civil money penalty authority and increased penalties, and public disclosure of enforcement orders.[3] Thereafter, in 1988 Mr. Barnard and Mr. Wylie introduced H.R. 3929, to carry out these recommendations and other provisions set forth in a similar proposal by the bank regulatory agencies. Much of H.R. 3929 subsequently was incorporated in Title VI of the Depository Institutions Act of 1988 (H.R. 5094), which was reported out by this Committee but never passed the 100th Congress. Then, at the beginning of this Congress, Committee Chairman Gonzalez introduced H.R. 32 (with Messrs. Barnard, Wylie, and Hiler as co-sponsors), which incorporated the previous Title VI. Title IX of this bill is more comprehensive than H.R. 32, because it includes a number of the Administration's proposals.

Recognizing the pressing need for the civil and criminal enforcement provisions in this title, the Committee carefully crafted a reasonable substitute title to reach the same objectives as the Administration's Title IX. This substitute closes certain loopholes; correlates serious penalties to serious misconduct; provides for expanded due process procedures and judicial review; discards confusing language; and, addresses a number of problems not covered in the Administration's bill. The Committee's substitute for Subtitle E, the criminal enhancement provisions, addresses concerns by several members of the Judiciary Committee by narrowing the scope of a number of provisions (for example, the substitute increased the "need" threshhold for transmittal of grand jury information under court order and limited such transfers to the banking agencies).

In general, the Committee's bill contains the following elements: First, Subtitles A–D provide the banking agencies with expanded uniform enforcement powers and necessary clarification of existing law, and also impose on each banking agency increased disclosure and reporting responsibilities. Second, Subtitles E and F implement recommendations in House Report 100–1088 and incorporate the essential elements from the Administration's bill. Subtitles E and F: (a) establish a new civil penalty; (b) increase the penalties for financial institution related offenses; (c) provide direction to the U.S. Sentencing Commission to overcome the problem of lenient sentences; (d) authorize the appropriation of additional funds to the Department of Justice to hire a large number of FBI agents, assistant U.S. Attorneys, and Fraud Section attorneys for its bank fraud*262 efforts; (e) extend the statute of limitations for financial institution criminal offenses, so that many of these pending cases could still be investigated and will not be barred by the current statute of limitations; and (f) create two regional Fraud Section offices to prevent significant waste of funds and inefficiencies.

**167 The Committee believes that the enhancement of the regulatory powers and criminal justice provisions should go far in restoring public confidence in the nation's financial system and serve to protect the public interest. This Title gives the regulators and the Justice Department the tools which they need and the responsibilities they must accept, to punish culpable individuals, to turn this situation around, and to prevent these tremendous losses to the Federal deposit

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

insurance funds from ever again recurring.

Discussion of certain specific provisions

Subtitles A–D

Section 901: The Committee fully supports the application of the bank regulatory agencies' enforcement authority to active shareholders, to independent contractors, including attorneys, appraisers, and accountants, and to other persons, but only if they participate in the conduct of the affairs of an insured financial institutions.

Purpose of specifying certain professions and categories: This section is not meant to be inclusive as to all the categories of persons who may be found to participate in the conduct of the affairs of an insured institution. The language "may include" after "persons participating in the conduct of the affairs of" an institution is meant not to exclude other participating persons including other unspecified independent contractors or financial institutions insiders, but to draw the banking agencies' attention to certain categories of persons and to support application of the agencies' enforcement authority over them.

Balancing legitimate concerns with enforcement needs: Section 901 places limitations on the banking agencies, so that they cannot utilize their enforcement authority over independent contractors for necessarily the same misconduct, abuse, or violations which can give rise to enforcement orders against officers, directors, and employees of financial institutions. Appraisers, accountants, and attorneys have participated in some of the serious misconduct in banks and thrift institutions and are defendants in numerous lawsuits brought by the FDIC and the FSLIC. However, the inclusion of these independent contractors has raised the concern of the American Institute of Certified Public Accountants, the American Bar Association's Business Law Section, and other groups. The Committee believes that section 901 addresses those concerns. Accordingly, the Committee has limited the exposure of independent contractors to serious misconduct.

Concern was also expressed that a banking agency could obtain enforcement orders against a corporation, firm, or partnership, such as a large accounting, appraisal, or law firm, since the term "person" includes entities as well as individuals, and that therefore enforcement orders would not be limited to those individuals who may have been responsible for the wrongful action. accordingly, ***263** the Committee expects the banking agencies to limit enforcement actions in the usual case to individuals who have participated in the wrongful action, to prevent unintended consequences or economic harm to innocent third parties.

****168** However, the Committee strongly believes that the agencies should have the power to proceed against such entities if most or many of the managing partners or senior officers of the entity have participated in some way in the egregious misconduct. For example, a removal and prohibition order might be justified against the local office of a national accounting firm if it could be shown that a majority of the managing partners or senior supervisory staff participated directly or indirectly in the serious misconduct to an extent sufficient to give rise to an order. Such an order might well be inappropriate if it was taken against the entire national firm or other geographic units of the firm, unless the headquarters or these units were shown to have also participated, even if only in a reviewing capacity.

By specifying "attorney" in this section, the Committee does not intend to subject attorneys to agency enforcement actions for those good faith activities falling within the traditional attorney-client relationship. Specifically, providing advice in good faith to a client financial institution, by itself, should not lead to an enforcement action. For example, an attorney who provides legal advice or other legal services in good faith to a financial institution may counsel the institution that a particular course of action is lawfully justifiable, because of unclear law or regulations or because the institution may succeed on a legal challenge to the law or regulation during an administrative or judicial proceeding. That such advice or services may conflict with the position of the Federal banking agency and that a court may determine that position to be wrong would not usually or necessarily show bad faith. Also, the legal advice provided under these circumstances would probably not be considered "counselling" a violation of law, one of the definitions of "participation" specifically cited in section 8(i) of the Federal Deposit Insurance Act, amended by section 907. (Such advice, however, will

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

not shield the client from civil enforcement action and would only be relevant as a mitigating factor in a civil money penalty action.)

Thus, under most circumstances, such advice would not constitute a participation in the conduct of the affairs of the institution. However, an attorney who does provide legal advice and services and then knowingly participates in other activities which result in serious misconduct would be subject to enforcement actions. Moreover, repeated legal advice to violate a banking law provision in title 12, U.S. Code, where the meaning of the provision is clearly established or settled by the courts, would not usually constitute good faith, and could possibly subject the attorney involved to enforcement action, if the grounds for such an action are present (and conceivably could give rise to State bar disciplinary proceedings).

Section 902: This provision in no way affects the ability of the AICPA, State Bar agencies, or other State licensing agencies to take disciplinary action or of plaintiffs to bring malpractice cases. Respondents in Federal banking agency enforcement proceedings have often contested the agency's authority to issue cease and*264 desist ("C & D") orders to require an institution to take certain actions or to obtain restitution or reimbursement from individuals. This provision clarifies the banking agencies' authority. It also overrules the 7th Circuit Court of Appeals decision in Larimore v. Comptroller of the Currency, 789 F.2d 1244 (1986), which held that C & D authority of the banking agencies did not authorize the OCC to seek in a C & D order reimbursement from a director of a national bank, who participated in violations of the National Banking Act. The Larimore case has caused confusion in the banking legal community, especially since the underlying conduct in that case did not involve unjust enrichment or harm to the institution. This section would allow such restitution, reimbursement, or indemnification for cases involving unjust enrichment or reckless disregard by the individual involved.

**169 Section 903: Under existing law, in order for a banking agency to remove an individual from an institution it must prove as one of several grounds, that an institution has suffered or will probably suffer "substantial" financial loss. This section deletes "substantial" (as well as "seriously" before prejudice to the interests of the depositors), to allow an agency to proceed with such an enforcement action whenever the institution has suffered any financial loss and has been harmed. The higher threshold found in current law has resulted in the FDIC losing cases at an early stage because the losses were not yet high enough (in the hundreds of thousands of dollars in one case) or because the FDIC could not quantify the losses. Ironically, some of these institutions later failed. The regulators must be given the opportunity to proceed before losses become even greater.

Section 904: This provision differs significantly from the Administration's proposal, which would not have prohibited an individual who has been removed from commencing new employment in or affiliations with other financial institutions. It was also unclear how the Administration's bill would have been enforced. The industry wide application of removal/prohibition orders is automatic under this section 904, and violations of such an order give rise to criminal liability under section 908.

The provision authorizes a banking agency to provide an exception for an individual to work or participate in an institution regulated by that agency, so the bar is not absolute. The Committee expects the banking agencies to carefully investigate requests for specific exceptions to the industry wide bar to determine if an individual has been truly rehabilitated, and therefore to be very cautious in granting such exceptions. There is no constitutional or other right for an individual to remain in the financial services industry, especially after a banking agency has met the high burden of proof in obtaining a removal/prohibition order, and after such an individual has had an opportunity to contest and appeal this order. To ensure such caution, the agency considering such an exception must consult with the other banking agency which issued the original order, before granting such consent, and all such written consents must be reported to the FDIC and be made public.

Section 905: The D.C. Circuit Court of Appeals held in Stoddard v. Board of Governors of the Federal Reserve System (No. 88–1148, March 3, 1989) that an individual who resigns or otherwise departs*265 from an institution is beyond the enforcement jurisdiction of the banking agencies, no matter how culpable that person may be. This resolved some ambi-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

guity which existed before the Stoddard decision as to when enforcement actions could be initiated. Financial institution officers, directors, and employees frequently resign or otherwise depart an institution, sometimes in response to banking agency pressure, but at times to thwart the initiation of an agency enforcement action. Sometimes an agency finds substantial misconduct long after the culpable individual has left and an institution has failed. To respond to the concern of the banking agencies that this provision apply to a number of currently pending informal enforcement actions, which have been stayed awaiting congressional action on this issue, the Committee states unequivocally that this section does not create a new offense, clarifies the ambiguity perceived by the court in the Stoddard case, and is procedural in nature, allowing the agencies to apply this section to individuals who have departed from institutions within the last five years. For that reason, the Committee did not include an "effective date" clause, as it did with sections 903 and 907.

**170 Section 907: This provision retains the Administration's proposal for a $1 million per day civil money penalty ("CMP"), but limits its application to serious misconduct resulting in substantial loss to the financial institution or a substantial gain to the guilty party (thus rejecting the ambiguous "reckless disregard for safety and soundness" language in the Administration's bill). Also, this section lowers the regular CMP from $25,000 to $15,000 per day.

The subsections in this section completely reorganize all, if not most, CMP provisions throughout the banking statutes, modeling them on Federal Deposit Insurance Act section 8(i) (as reorganized in subsection (a) of section 907). For example, in subsection (a), Clause F restates the four major mitigating factors, such as the good faith of the institution and the gravity of the violation, among other things. The Committee expects the banking agencies to take into account mitigating, as well as any aggravating factors, in determining CMP amounts. In that regard, the Committee strongly encourages the regulators to adopt and utilize the interagency policy concerning the assessment of civil money penalties, issued by the Federal Financial Institution's Examination Council in 1980. The 13 guidelines contained in that policy statement should be considered whenever a regulatory agency is assessing the CMP. The FFIEC guidelines specifically do not preclude any regulatory agency from considering other matters relevant to the consideration of a CMP assessment.

Amounts collected under the CMP provisions shall no longer be received by the Treasury but will be paid to the banking agencies to defray some of their enforcement expenses.

Because the new enforcement authority will only apply to future misconduct and not to the past insider abuse giving rise to the need for this legislation, the Committee decided to allow the banking agencies to apply the increased amount of the penalty, the $15,000 CMP, to recent past misconduct. However, neither the new expanded grounds for CMPs nor the $1 million penalty, both of which this section provides for, will apply to any prior misconduct. And only misconduct unknown to the banking agencies, which has*266 occurred since the last examination—probably within the last 1 or 2 years—will be subject to the $15,000 penalty. Fairness dictates that a banking agency, which knew about misconduct (based on an examination) and could have imposed, but did not, a CMP, cannot do so now only because of the increased amount.

Section 909: Agencies have been known to withhold documents from the FDIC, in connection with the FDIC's exercise of its receivership responsibilities for failed banks. This section places on the banking agencies an affirmative responsibility to no longer withhold such documentation. This sharing of documentation shall in no way constitute a waiver of any governmental agency, work product, attorney-client or other privilege recognized by the courts or by statute.

**171 Section 911: Penalties for submission of false or misleading call reports will provide a much needed incentive to encourage financial institutions to file timely and accurate call reports, which are important indicators of the financial condition of an institution.

The Committee expects the banking agencies to recognize that the severity of the penalty must correlate with the seriousness of the offense. Institutions which unintentionally or inadvertently file inaccurate or slightly late reports should not receive severe penalties. Accordingly, the Committee intends that the increased CMP maximums should be imposed for chronic late filing, for deliberate delays in order to postpone the release of adverse financial information, and for repeated or serious inaccuracies.

Unlike the Administration's bill, this section expressly incorporates the due process procedures contained in section

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

8(i) of the Federal Deposit Insurance Act. Incorporation of the due process hearings, rights to appeal, and criteria for the imposition of penalties (including mitigating circumstances) is based on the Committee's belief that the agencies should not be able to impose substantial CMPs without making such rights and procedures available to respondents.

Section 913: The bank regulatory agencies, with infrequent exceptions, do not disclose civil enforcement actions. (They are the only Federal regulatory agencies which do not do so.) This policy and has been specifically criticized in congressional reports and during congressional hearings. One of the problems in the financial services industry (except for SEC-regulated institutions, which must disclose such enforcement actions) has been the excessive secrecy of agency supervisory actions. Such secrecy does little to deter misconduct, but does serve to ultimately worsen the problems of financial institutions. The October 1988 Government Operations Committee report specifically recommended legislation to require the banking agencies to publicly disclose all formal civil enforcement actions and any modifications to or terminations of such orders. Disclosure could be delayed only in those rare instances where it would imminently jeopardize the institution's solvency. The Committee strongly believes that more disclosure of formal enforcement orders will help prevent insider misconduct.

Section 919: The General Accounting Office and the House Government Operations Committee have urged additional delegation of enforcement activity to banking agency regional offices or district banks, in order to improve the timeliness and effectiveness of the*267 enforcement process. The extent of delegation is different for each of the Federal banking agencies, with some, such as the OCC, having delegated more than other agencies. The balanced composition of the task force mandated by this section ensures that views of regional and district officials will be taken into account.

Section 920: This section is designed to remove the fear of intimidation felt by supervisory agents who are threatened with civil lawsuits for making criminal referrals or providing relevant information to other regulatory agencies. The Committee believes that comprehensive legislation is needed to protect Federal employees from unwarranted and unjustified lawsuits. However, until Congress fully studies that issue, this provision is necessary. This immunity will not affect any other pre-existing immunities.

**172 Section 931: The Committee believes that independent auditors should receive copies of an institution's examination and call reports and also any informal or formal supervisory actions. The Committee believes that the continued refusal of the banking agencies to require this sharing of data is unreasonable, and therefore the Committee has incorporated this provision to mandate it. The Committee expects the agencies to take enforcement action for violations of this provision.

Introductory Note: The Right to Financial Privacy Act ("RFPA") amendments fall into two categories; technical ones to expand coverage to entities affiliated with banks and substantive ones to respond to problems documented by both this Committee and the Committee on Government Operations.[4]

Section 942: Federal prosecutors and FBI agents are reluctant to disclose financial records information to the banking agencies, even where that information would be very useful to those agencies in carrying out their supervisory responsibilities. FBI agents and Federal prosecutors have interpreted the RFPA to prevent disclosure to these agencies of information which those agencies could have obtained on their own without restriction (because of 12 U.S.C. 3213(b)). This has prevented the FDIC from recovering millions of dollars. This amendment would resolve ambiguities in current law and help to recover the fruits of bank and S & L fraud.

Section 943: Financial institutions routinely notify persons of grand jury subpoenas. In fact, financial institutions appear to go out of their way to provide unnecessary notice to individuals of the existence of a subpoena, including individuals who had allegedly victimized specific institutions. U.S. Attorneys are expending precious resources to obtain non-disclosure notices. Disclosure to alleged perpetrators often impedes and harms the investigation. This section would expressly prohibit such notification.

Section 944: The banking agencies have invoked the RFPA to prevent sharing with the SEC information pertaining to a publicly traded holding company or another entity affiliated with a publicly held financial institution, even where the alleged securities law violation may involve an entity and not an individual, in which case RFPA does not apply. The

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

SEC also encounters delays in obtaining information from these agencies. Better enforcement results*268 from better coordination and interagency sharing of data. The Committee encourages the banking agencies and the SEC to share all pertinent data between them under this exception.

Subtitles E and F

Section 951: This section authorizes the Attorney General to recover a civil penalty for conduct violating specified provisions of title 18, United States Code, involving financial institutions. The maximum civil penalty is the lesser of $1,000,000 per day or $5,000,000. If there is a higher pecuniary loss to a financial institution or gain to an offender, the penalty may equal that loss or gain.

**173 The Attorney General recovers the civil penalty through a civil action brought in a United States district court. The Attorney General must establish the right to recover by clear and convincing evidence, a standard that is higher than the "preponderance of evidence" standard proposed by the Administration. The Committee adopted the higher standard because the seriousness of the penalty warrants a higher standard and because most of the cases likely to be brought under this section will involve allegations of fraud, the type of cases for which State law frequently requires the clear and convincing evidence standard.

Section 961: This section increases criminal penalties for offenses in title 18 of the United States Code that affect financial institutions. Section 961 raises the maximum penalty for these offenses to a fine of $1,000,000 and 20 years imprisonment. These are the highest penalties invoked for white collar crime, comparable to the penalties for money laundering under 18 U.S.C. 1956 and 1957. The present maximums are generally a $10,000 fine and 5 years imprisonment.

Section 961 also consolidates sections 1007 and 1008 of title 18, United States Code. This consolidation is not intended to alter or affect the jurisdiction of those Federal law enforcement agencies, including the U.S. Secret Service, which currently have jurisdiction to investigate such offenses.

Section 961 extends the statute of limitations period from five years to ten years for specified banking offenses, and applies the new period retroactively to those offenses for which the present statute of limitations period has not expired. The longer period of limitations is necessary because of the enormous backlog of thousands of currently pending investigations and prosecutions and the complexity of many of the cases.

Finally, this section directs the United States Sentencing Commission to set at 24 the offense level for specified banking offenses that jeopardize the safety and soundness of a financial institution. The guideline sentence for a first-time offender under level 24 is 51 months to 63 months.[5] Implementation of this directive will require the Sentencing Commission to define in the sentencing guidelines what conduct "substantially jeopardizes the safety and soundness of a Federally insured financial institution". In developing such a definition, the Sentencing Commission will undoubtedly want to consult with the Federal agencies that regulate financialinstitutions.*269 Section 961 differs from the Administration's proposal by sunsetting the guideline requirement on December 31, 1993. The Committee believes it is important to give the Sentencing Commission flexibility in the future to adjust the guidelines in response to other conditions, such as prison overcrowding.

Section 962: This section makes technical amendments to title 18 of the United States Code, such as replacing the term "Federal Home Loan Bank Board" in title 18, United States Code, with the term "Office of Thrift Supervision".

**174 Among more substantive changes, this section broadens 18 U.S.C. 212 and 18 U.S.C. 213 to prohibit offers or acceptances of loans or gratuities to financial institution and OTS examiners. The section also expands 18 U.S.C. 1510 to prohibit disclosure of any information about a grand jury subpoena of records of a customer of a financial institution. Premature disclosure of the existence of such a subpoena can seriously hamper an investigation or prosecution. The section makes it an offense for an officer, director, partner, employee, or attorney of a financial institution knowingly to notify (1) the customer whose records are sought, or (2) a target of the grand jury investigation. (Section 943 describes the serious problems to which this section responds.) The maximum penalty is five years imprisonment and a fine under title

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

18, U.S. Code.[6]

Section 963: This section provides for civil and criminal forfeiture in connection with title 18 offenses affecting financial institutions. The Department of Justice has similar forfeiture authority for money laundering and domestic Bank Secrecy Act violations (sections 981 and 982 of title 18, United States Code). Proceeds from civil forfeitures will be distributed in a manner that should ensure equitable reimbursement of the affected governmental agencies. First, the regulatory agency is reimbursed for out-of-pocket expenses incurred during its investigation leading directly to the seizure and forfeiture, and then the Justice Department for its out-of-pocket expenses incurred during its investigation leading directly to the seizure and forfeiture. If the institution is in receivership or has been liquidated, the Federal agency regulating the affected institution is reimbursed for losses to its insurance fund and for payments made to claimants, creditors, or depositors. If the institution is not in receivership or liquidated, the proceeds go to the General Fund of the Treasury, but may be made available to the appropriate Federal regulatory agency as restitution to the financial institution. Criminal forfeitures are disposed of in accordance with the Comprehensive Drug Abuse Prevention and Control Act of 1970.[7]

Section 964: This section adds a new section to chapter 215 of title 18, United States Code, to provide for limited disclosure of grand jury information. Section 964 permits disclosure of matters occurring before a grand jury concerning a banking law violation in two circumstances. First, such information can be disclosed to attorneys in the Justice Department who are enforcing the civil*270 penalty authorized in section 951 of the legislation. The disclosure takes place without a court order.

Second, such information can be disclosed to identified personnel in a Federal financial institution regulatory agency, but only with a court order. The court acts upon a motion filed by an attorney for the government, and may issue a disclosure order upon a finding of particularized need. A person to whom the information is disclosed may use the information only in relation to a matter within the jurisdiction of the agency, or to assist a Justice Department attorney to enforce section 951 of the legislation. Heretofore, the banking agencies have been denied such information, which would have enabled them to respond much earlier to misconduct, to take actions to prevent an institution's failure, and to recoup funds uncovered by Federal prosecutors, to use for the benefit of the Federal deposit insurance funds or open institutions.

**175 Section 965: By establishing two regional offices of the Fraud Section (part of DOJ's Criminal Division) in the Northern District of Texas (which includes Dallas) and Southern California, the Justice Department could annually save hundreds of thousands of dollars in travel costs. Travel fund shortages, which continually recur within the Criminal Division, have adversely affected the Fraud Section's ability to prosecute these cases, particularly in the Southwest and West. (For example, recently, Dallas area S & L investigations were delayed 8 to 9 months because of an acute travel fund shortage, and the Fraud Section rarely accepts new cases from anywhere in the West because funds are still inadequate.) Apart from saving the Department of Justice money, this section will enable Fraud Section attorneys to handle these cases more efficiently and expeditiously. The Department should incur very little in the way of transfer costs because it plans to hire 24 Fraud Section attorneys with the funds authorized in section 966.

Section 965(b) requires that the GAO conduct a study within 180 days after the enactment of the legislation on the possible need for additional regional offices or task forces.

Section 966: This section authorizes $65 million in appropriations for investigating and prosecuting financial institution crimes for the next 3 years. Witnesses before this Committee and also the Committee on Judiciary's Subcommittee on Criminal Justice testified to the overwhelming need for funds for these purposes. The Committee has, accordingly, authorized $15 million more than the amount requested by the Administration. In recognition of the Justice Department's new authority in enforcing civil penalties, $10 million is authorized for civil litigation involving financial institutions. This section also provides that these funds may not be used to supplant currently authorized funds and prohibits reallocation of the funds for other purposes. Finally, the Justice Department is required to report to Congress on the use of appropriated funds and on the numbers of financial institution fraud cases, for each of the 3 years.

*271 TITLE X—STUDY OF FEDERAL DEPOSIT INSURANCE AND BANKING REGULATION

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Summary

It is the firm intention of the Committee to conduct continuing vigorous oversight on the regulation and soundness of the insurance funds. The Committee will carefully consider all issues which may, in any way, impact on the Federal deposit insurance program. For this reason, the Committee requires studies described below to develop the information necessary to make informed decisions in related public policy areas.

Section 1001. Study of Federal Deposit Insurance System

The Department of the Treasury is directed in section 1001 to carry out a major study of the Federal deposit insurance system. Since the Treasury Department will oversee the operation of the regulators of the national banks and the thrifts, it is reasonable to expect a comprehensive study. The Treasury Department must consult with Federal bank and thrift regulators, the Director of OMB, and with qualified individuals from the private sector in the course of conducting this study.

**176 In broad terms, the Treasury Department will concentrate on the appropriate structure for a national deposit insurance system in which insured institutions are permitted to offer competitive products and services that are consistent with standards of safety and soundness. Specific concerns of the Committee are described in section 1001 to ensure that adequate attention is given to these areas.

One of these issues is the concept of risk-weighted assets and liabilities. Reflecting a sense of realistic value, risk-based capital is a vital part of the proposed capital standards for national banks and thrifts. The Committee agreed that the Treasury Department should evaluate the feasibility of establishing a deposit insurance premium structure that would consider asset quality risk, interest rate risk and the quality of management, profitability as well as capital.

Other issues the Committee directed Treasury to include in the study relate to incentives for market discipline. Included in the study are the advantages of limiting each depositor to one insured account per institution; of reducing the amount insured or establishing a graduated scale according to which marginal insurance coverage declines from one hundred to zero percent; and of combining Federal with private insurance.

Another important study area deals with the scope of deposit insurance coverage and its impact on the liability of the insurance fund. Because of the rapidly increasing number of competitive instruments being offered by insured institutions, the Committee felt it was imperative to determine the relative risks of these products so as to be able to have a sound basis on which to make decisions relating to the extension deposit insurance.

The Committee identified for study the feasibility of some sort of assessment for insured institutions with foreign deposits. The Committee considered the impact which foreign deposits have as potential liabilities to the fund but did not resolve the appropriateness of assessing these institutions.

*272 The question of providing limitations on brokered deposits was debated within the context of safety and soundness considerations. The Secretary of the Treasury is directed, as part of this study, to consider the feasibility of limiting deposit insurance on brokered accounts.

The Committee is concerned that widespread disparities among Federal and State bankruptcy law exemptions may pose both serious equity problems and a drain on the deposit insurance funds. Overly generous exemptions may make it difficult for insured institutions to collect on loans. In an economic downturn, the health of institutions could be jeopardized and the exposure of the deposit insurance fund could increase significantly. The Committee directs the Treasury Department and the regulatory agencies to assess the magnitude of this risk and to advise the Committee how a Federally insured institution could reduce the risk to the deposit insurance funds.

**177 The Committee also notes that some States require mortgages on property to be accompanied by a personal or corporate bond or note so that if the proceeds of a foreclosure sale are not sufficient to repay obligations the institution can, without delay or great expense, attach other personal or corporate assets. These bond requirements may encourage more responsible borrowing and reduce losses to insured institutions, and consequently to the deposit insurance funds. The Committee directs the Treasury Department in this area to determine whether or not such requirements would be ad-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

visable at the national level.

The Committee recognizes that the regulatory agency's decision to recapitalize or close insolvent financial institutions can be a difficult choice. Each institution deserves attention to its own circumstances, but it is the responsibility of the Congress to set policy in this area, especially when the choice to liquidate an institution dramatically affects the employees, depositors and their community. The Committee directs the Treasury Department to recommend policies to be followed under such circumstances.

In a previous section of this bill, the Committee agreed to have the Federal home loan banks set aside funds to specifically serve the housing needs of low and moderate income individuals. It is the intent of the Committee that the Treasury Department review the effectiveness of the use of such funds.

In reviewing "alternatives to Federal deposit insurance," the Treasury Department shall study various alternatives such as: supplemental private deposit insurance (private insurance on account balance over $100,000); the sharing of deposit insurance risks between the Federal government and State governments; reinsurance of a portion of the Federal deposit insurance risk exposure with private sector insurance companies; and complete privatization of depositor insurance.

The Treasury Department shall study the feasibility of refining the relationship between independent auditors and accountants of insured institutions and the Federal and State examiners of those institutions to assure more direct contact and cooperation between the auditors and accountants and the examiners. The study shall include an analysis of The Bank of England's relationship with auditors and reporting accountants as outlined in provisions of its*273 "Banking Act, 1987," and the feasibility of applying similar regulations to our institutions.

The Treasury Department study shall be submitted to the Congress within eighteen months from the date of enactment.

Section 1002. Survey of bank fees and services

The industry will be required to pay higher premiums for deposit insurance to offset some of the costs of the assistance provided by this Act. However, the Committee is concerned that much of the costs of the higher insurance premiums will be shifted to the customer in the form of higher fees for retail financial services and by a diminution of services.

**178 Section 1002 requires the Federal Reserve Board, in cooperation with the other Federal supervisory agencies, to conduct an annual survey of the level and cost of retail services. The survey is to take special note of any correlation between increases in fees and increases in premium paid by institutions for deposit insurance or decreases in services.

The Committee believes that the survey and disclosure required by this section should help dampen the tendency to dump, wholesale, the costs of the bailout on consumers.

Section 1003. Limitations on expanding deposit insurance coverage

The Committee believes it is reasonable to disallow extensions of deposit insurance during the period necessary for the Department of the Treasury to conduct the study described in section 1001. Accordingly, during this time, the FDIC may not prescribe, issue or implement any regulation, order or interpretation which has the effect of extending deposit insurance coverage to any obligation of insured financial institutions that would not be treated as an insured deposit on April 6, 1989. Section 1003 also prohibits the extension of deposit insurance on a pro rata or pass-through basis to individual investors in any unit investment trust or individual participants in any pension or profit-sharing plan if such coverage was not available to these investors or participants on April 6, 1989.

An exception was adopted by the Committee to remedy a potential problem for some State and local employee pension plans that have invested in bank certificates of deposit. During consideration of this Act, some pension plans indicated their intent not to renew certificates of deposit if Federal deposit insurance did not attach to them. This interpretation of this section would cause certain pension plans to lose a valuable investment vehicle and cause a major withdrawal from a number of community banks. Given the fact that some pension plans invest in traditional certificates of deposit, not bank investment contracts (BICs), this exception is intended to allow such certificates of deposit to be rolled over and insured

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

by Federal deposit insurance.

Section 1004. General Accounting Office study

The General Accounting Office has provided considerable and invaluable assistance to the Committee in its efforts to formulate an appropriate response to the savings and loan industry crisis. With their experience and expertise in insuring fund issues, the Committee, in section 1004, directs the GAO to report to Congress on the*274 results of a study of deposit insurance issues. In particular, the report will emphasize an analysis of the policy considerations affecting the scope of deposit insurance coverage; an evaluation of the risks associated with BICs, both as to the issuing institution and the deposit insurance funds; and the effect of proposed changes in the definition of "deposit" on market discipline and the ability of other participants in capital market to raise funds.

Section 1005. FDIC report on deposit insurance funds

**179 In Section 1005, the Committee bill requires the FDIC to provide Congress with annual reports on the economic condition of the insurance funds and the ability of each fund to satisfy the insurance claims which may be made. The purpose of the report is to identify the economic risks imbedded in the Federal deposit insurance system, and to disclose, through a sensitivity analysis, how these economic risks will affect the insurance funds under a variety of economic conditions and scenarios. This kind of information is essential if the Congress, the regulators, and the industry are to understand the true financial risks to the system and the funds.

TITLE XI—REAL ESTATE APPRAISAL REFORM AMENDMENTS

Summary

The provisions of Title XI are intended to protect Federal financial and public policy interests in real estate related financial transactions requiring the services of an appraiser. Its purpose is to provide the affected federal entities with a reasonable degree of assurance that real estate appraisals utilized in connection with Federal responsibilities and requirements are performed in accordance with uniform standards by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. Specifically, the title requires the use of State certified or licensed real estate appraisers and a system of uniform national appraisal standards for real estate related financial transactions engaged in, contracted for, or regulated by the Federal Financial Institutions Regulatory Agencies, by the Resolution Trust Corporation, by the Federal National Mortgage Association, and by the Federal Home Loan Mortgage Corporation. July 1, 1991 (with a possible extension until December 31, 1991), is the date beyond which only State certified or licensed appraisers can be used.

Establishment, functions, and administrative powers of the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (FFIEC)

Sections 1101 through 1105 establish an Appraisal Subcommittee within the FFIEC, establish its functions and define its powers. Except as otherwise specified, all of the functions and responsibilities assigned to the FFIEC under Title XI are to be performed directly by the Appraisal Subcommittee without the need for any approval or concurrence from the Council. Given the crucial role appraisals play in the safety and soundness of the underwriting of real estate related loans and investments, it is the Committee's intention that those designated as members of the Appraisal Subcommittee not only be knowledgeable and competent concerning the *275 appraisal function but also be high ranking employees of the agencies comprising the FFIEC.

Further, while Title XI makes each Federal Financial Institutions Regulatory Agency and the Resolution Trust Corpor-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ation separately responsible for its own appraisal standards and determinations concerning the use of certified or licensed appraisers, the Appraisal Subcommittee is charged with responsibility for achieving maximum feasible comparability of such standards and determinations. The Committee believes that comparability is particularly important with respect to the Nation's financial institutions where significantly different requirements could create competitive advantages or disadvantages. Because the five Federal bank regulatory agencies perform similar supervisory functions, because uniform supervisory practices is an ongoing objective of the banking agencies, and because the avoidance of competitive inequalities has been a goal of the Congress, the Committee believes that appraisal standards and determination concerning which transactions should be performed by a certified appraiser and which by a licensed appraiser, can and should be identical or substantially the same for each agency.

**180 Another function required of the Appraisal Subcommittee involves the monitoring and reviewing of the Appraisal Foundation. The title recognizes the Foundation as the legitimate representative of the Nation's leading professional real estate appraisal organizations and empowers the Foundation to perform a number of significant responsibilities in connection with the purposes of the title. Moreover, Title XI authorizes the Appraisal Subcommittee to provide financing to the Foundation for certain specified purposes and under certain conditions. In recognition of these powers and the benefits conferred, the Committee intends that the Appraisal Foundation represent, fully and fairly, the broad spectrum of recognized professional appraisal organizations, large and small, and the interests of responsible appraisers who are unaffiliated with any professional appraisal organization. This contemplates that the Foundation's membership requirements, organizational structure, and voting arrangements will be democratic.

Finally, the Appraisal Subcommittee is mandated to closely monitor, in their entirety, State systems for the certification and licensing of individuals who will be performing appraisals in connection with Federally related transactions.

Procedures for establishing appraisal standards and determinations regarding the use of State certified or State licensed appraisers

Section 1106 requires that each Federal Financial Institutions Regulatory Agency and the Resolution Trust Corporation establish appraisal standards and make determinations concerning the use of certified or licensed appraisers in connection with various real estate related financial transactions; and that these standards and determinations be prescribed by rulemaking under the Administrative Procedure Act. At the discretion of the Federal agencies and the Resolution Trust Corporation, public hearings or the receipt of written comments or both, may be required.

*276 Funding of Appraisal Subcommittee; use of funds

Sections 1107 and 1108 establish the funding mechanism for the Appraisal Subcommittee and the manner in which such funds may be expended. Given the central role of sound appraisal practices in connection with Federally related transactions, Title XI authorizes a one-time appropriation of $5 million to the Appraisal Subcommittee so that it can quickly begin to carry out its responsibilities. Additional funding is authorized through the collection of small annual fees from certified or licensed appraisers whose names will appear on a registry of appraisers eligible to perform appraisals in Federally related transactions. Additionally, and pursuant to section 1121(b), funds available to the Federal Financial Institutions Regulatory Agencies may be made available to the FFIEC to support functions of the Appraisal Subcommittee under this title.

It is the Committee's intention that the Appraisal Subcommittee reimburse the general fund of the Treasury for amounts appropriated to and expended by the Subcommittee, pursuant to a repayment schedule established after consultation with the Secretary of the Treasury. The Appraisal Subcommittee is also authorized to make grants, in such amounts as it deems appropriate, to the Appraisal Foundation.

Functions of Federal Financial Institutions Regulatory Agencies and the RTC relating to appraisal standards; additional

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

standards authorized; times for proposal and adoption

**181 Sections 1109 through 1110 require each Federal Financial Institutions Regulatory Agency and the Resolution Trust Corporation to prescribe appropriate appraisal standards in connection with all Federally related transactions under their jurisdiction; and that the standards conform to the appraisal standards promulgated by the Appraisal Foundation. In recognition of the possibility or even likelihood that the Financial Institutions Regulatory Agencies and the Resolution Trust Corporation may need to adopt appraisal standards in addition to those promulgated by the Appraisal Foundation, the title explicitly authorizes them to do so.

Because State certified or licensed appraisers may be required to adhere to appraisal standards in addition to those promulgated by the Appraisal Foundation or the states, it is the Committee's intention that for purposes of Federally related transactions, certified or licensed appraisers adhering to such additional appraisal standards shall be deemed to be in full compliance with the provisions of this title; and that no State certifying and licensing agency shall regard compliance with any such additional standards to be a violation of its requirements.

Functions of the Federal Financial Institutions Regulatory Agencies and the Resolution Trust Corporation relating to appraiser qualifications; additional qualification criteria authorized; determinations concerning the use of certified or licensed appraisers; times for proposal and adoption of requirements

Section 1111 requires each Federal Financial Institutions Regulatory Agency and the Resolution Trust Corporation to prescribe categories of Federally related transactions that must be appraised by*277 a State certified appraiser and categories that must be appraised by either a State certified or licensed appraiser. Section 1112 requires the use of State certified appraisers in Federally related transactions having a value of $1 million or more or when a Federally related transaction, either individually or together with others, is of sufficient size or complexity or is of sufficient financial or public policy importance to the United States. The Committee has knowledge of and approves the qualification standards established by the Appraisal Foundation for those individuals who seek to become certified appraisers. In connection with Federally related transactions under the title, State certification requirements will have to conform, at a minimum, to Appraisal Foundation requirements. However, with respect to licensing qualifications, the Committee recognizes that some States may establish requirements that are insufficient to protect Federal financial and public policy interests. Accordingly, it is the Committee's intention that there be a presumption in favor of the use of certified appraisers for Federally related transactions. Similarly, in keeping with the objective of the Act to ensure the stability of residential mortgage markets and to prevent a recurrence of widespread thrift institution failures and to minimize losses in the secondary mortgage markets, it is appropriate that Federally insured financial institutions having a large concentration of their loans in residential home mortgages, use State certified appraisers for a majority of their loans and investments secured by those residential properties. It is the Committee's further intention that in deciding which Federally related transactions should be performed by certified appraisers, as opposed to licensed appraisers, it is appropriate and necessary for the Federal agencies, instrumentalities and Federally recognized entities under the title to measure their financial liabilities and/or public responsibilities not against each transaction standing alone but rather against the sum total of such transactions over a period of time or even as to the geographical location of such transactions. This is particularly so in situations where mortgages are purchased by secondary market agencies for repackaging and sale to the investing public as mortgage-backed securities. In conclusion, it is the Committee's view that given the substantial protection that will accrue to the government and U.S. taxpayers through the use of certified real estate appraisers, impacted agencies, instrumentalities and Federally recognized entities should adopt a broad stance on establishing categories of transactions that will require the services of certified appraisers.

Certification and licensing requirements

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

**182 Section 1115 establishes requirements pertaining to the certification and licensing of individuals as real estate appraisers. Individuals who wish to become certified appraisers must satisfy State requirements that meet, at a minimum, the criteria for certification adopted by the Appraisal Foundation. Individuals who seek to become State licensed appraisers, must satisfy the requirements for licensing in the State in which they seek a license.

Subsection (d) explicitly authorizes each Federal agency, instrumentality and Federally recognized entity under the title to require that State certified or licensed appraisers have qualifications*278 in addition to those established by any State, as deemed necessary or appropriate.

Establishment and monitoring of State appraiser certifying and licensing agencies; criteria for disapproval of State agencies and rejection of State certifications or licenses

Sections 1116 and 1117 provide for the establishment and the monitoring of State appraiser certifying and licensing agencies. The Committee believes that while the Federal government has compelling financial and public policy interests in the establishment of uniform appraisal standards and a nationwide system of State certified and licensed appraisers, it is the States that are in the best position to award certifications or licenses to qualified individuals and to supervise the professional conduct of such individuals. Accordingly, the Committee urges States to establish, by July 1, 1991, certifying and licensing agencies that meet the requirements of the title so that appraisers in those states can perform appraisals in Federally related transactions. The Committee also believes, however, that the interests of the United States are sufficient to require the Appraisal Subcommittee to scrupulously monitor the systems established by States for the certification and licensing of appraisers in connection with Federally related transactions. In this regard, the Appraisal Subcommittee is required to review all aspects of a State's system for compliance with this title; and to reject appraiser certifications and licenses from States whose appraisal policies, practices or procedures are found to be inconsistent with this title. Paragraph (b) of section 1117 establishes criteria for the rejection of a State's appraiser certifications or licenses. Paragraph (3) of subsection (b) requires the Appraisal Subcommittee to disapprove appraiser certifications or licenses from State agencies whose "decisions concerning appraisal standards, appraiser qualifications, and supervision of appraiser practices are not made in a manner that carries out the purposes of this title." In this regard, it is the Committee's intention that these decisions be made by individuals whose responsibilities do not include the regulation or supervision of nonappraiser activities or conduct. Such independence is necessary to insure against conflicts of interest between the appraisal function and the functions of promoting or financing real estate related financial transactions.

Federal recognition of use of State certified or licensed appraisers; effective date temporary waiver of requirements; reports of appraiser misconduct

**183 Section 1118 establishes July 1, 1991, as the date after which all appraisals performed in connection with Federally related transactions under the title must be performed only by individuals who have been certified or licensed by States in accordance with the requirements of the title. Subject to the approval of the FFIEC, the Appraisal Subcommittee may extend the effective date of the title until December 31, 1991, under defined circumstances. Also subject to the approval of the Council, the Appraisal Subcommittee may waive temporarily any requirement relating to certification or licensing if certain written determinations are made. It is the Committee's*279 intention that this waiver authority be exercised cautiously.

It is also the Committee's intention that appraisals performed by State certified or licensed appraisers in Federally related transactions shall be acceptable when an individual who is not a State certified or licensed appraiser assists in the preparation of an appraisal if (1) the assistance is under the direct supervision of an individual who is a certified appraiser in a Federally related transactions requiring the use of a licensed appraiser; and (2) the final appraisal document is approved and signed by the supervising individual who is certified or licensed, as appropriate. It is also the Committee's intention that any Federal agency, instrumentality or Federally recognized entity under the title and anyone regulated by

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

or in a contractual relationship with them can contract with a corporation, partnership or sole proprietorship for the performance of an appraisal in a Federally related transaction so long as the appraisal will be performed by an individual who is a State certified or State licensed appraiser, as appropriate.

Requirements pertaining to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation

Section 1119 makes it a violation of the title for the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation or the Resolution Trust Corporation to knowingly contract for the performance of any appraisal by an individual who is not a State certified or licensed appraiser in connection with a real estate related financial transaction to which such association or corporation is a party. Subsection (a)(2) contemplates that Fannie Mae and Freddie Mac would be in compliance by including in their contracts with originating lenders that sell loans to them, a requirement for the use of certified or licensed appraisers for the real estate securing the loans. Fannie Mae and Freddie Mac are also required by this provision to use only certified or licensed appraisers for appraisals in connection with real estate owned by them as a result of foreclosure. Subsection (a)(2) also contemplates that the Resolution Trust Corporation would be in compliance by requiring the use of certified or licensed appraisers by those with whom it contracts or for its own appraisal related purposes.

****184** Under Title XI, Fannie Mae and Freddie Mac are expected to adopt policies, practices and procedures that will require the use of the most highly qualified class of appraisers and state-of-the-art appraisal standards. In this regard, it is the Committee's explicit intention that Fannie Mae and Freddie Mac will retain the full discretion now available to them to promulgate appraisal standards and appraiser qualification requirements that are in addition to minimum standards adopted by a Federal Financial Institutions Regulatory Agency, by the Appraisal Subcommittee or by any State under the title; and to determine the most appropriate timing and response to defects in State systems for certifying and licensing appraisers. Under this title, Fannie Mae and Freddie Mac may take such corrective measures as they believe necessary or appropriate without regard to prior decisions by the Appraisal Subcommittee***280** to reject State certification or licensing pursuant to section 1117 and without regard to section 1118 requiring "reports to State certifying and licensing agencies."

Miscellaneous provisions

Section 1121 sets forth certain miscellaneous provisions that are important to accomplish the purposes of the title.

Subsection (a) "Temporary Practice" provides for reciprocity between and among the States with respect to temporary practice in a State by a certified or licensed appraiser in a Federally related transaction. Specifically, the provision requires all States to recognize a certification or license of an individual issued by another State whose certification or licensing system meets the provisions of the title.

Subsection (c) "Prohibition Against Discrimination" prohibits the Federal agencies, instrumentalities and Federally recognized entities under the title from excluding an appraiser for consideration for an assignment solely by virtue of membership or lack of membership in any particular appraisal organization. This subsection explicitly authorizes affected agencies, instrumentalities and entities to establish such qualification criteria, in addition to those established by any State, they deem appropriate or necessary to carry out their responsibilities. However, any such additional qualifications must be reasonably related to the requirements of the assignment and reasonably related to the special skills that are required of an appraiser in an assignment.

As discussed elsewhere in this report, the Committee intends that criteria for certification and licensing be adequate to protect Federal financial and public policy interests. Where a Federal agency, instrumentality or Federally recognized entity believes that additional qualifications are desirable in connection with a particular appraisal assignment or category or appraisal assignments, such reasonable additional qualifications are encouraged. For example, it is perfectly reason-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

able and permissible under this title to require that an appraiser whose assignment involves a toxic landfill or other environmental hazard, have had prior experience appraising similar properties. What is not permissible under the title are exclusionary policies which are not reasonably related to the needs of the assignment. Specifically, the antidiscrimination provision prohibits exclusion of appraisers from consideration for assignments based on membership or lack of membership in any particular appraisal organization.

**185 There are a number of reputable appraisal organizations, such as those that are members of the Appraisal Foundation, which currently provide meaningful qualification, continuing education and ethical standards. Membership in such organizations should be encouraged because of the educational and skill enhancement benefits they provide. However, the majority of professional appraisers do not yet belong to any such organizations and congressional investigations have concluded that abusive appraisal practices include equally members of all professional appraisal groups, as well as those not belonging to any such groups. Accordingly, Federal interests are best served by a policy which prohibits categorical discrimination against appraisers by virtue of membership or lack of*281 membership in any particular appraisal organization. There is, however, nothing in this title which prohibits consideration of an appraiser's credentials, including certifications by such reputable organizations, in any selection process.

Subsection (d) provides for two important studies by the Appraisal Subcommittee—one involving the availability of comparable sales and financing information and data to appraisers; and the other concerning the extension of the provisions of the title to personal property appraising.

TITLE XII—MISCELLANEOUS PROVISIONS

INDEPENDENT ANNUAL AUDITS OF INSURED FINANCIAL INSTITUTIONS

The Committee's bill requires insured financial institutions to obtain an annual audit by an independent public accountant. In addition, the management of each institution is required to issue a report on their internal control structure and compliance with specific laws and regulations related to safety and soundness, which the independent public accountant is required to review. The auditor will also report on management's assertions contained in that report. The Federal Deposit Insurance Corporation is to prescribe (1) the rules and regulations for the management and independent public accountants' reports, and (2) alternative auditing and reporting requirements for insured banks with assets less than $150 million.

Background

The General Accounting Office recently completed a review of the factors that contribute to bank and thrift failures and reported its results to the Committee during field hearings held in San Francisco in January and San Antonio in March of this year. GAO described in detail the inadequate internal controls which regulators found at both failed banks and thrifts. The reviews also identified that Federal regulators almost uniformly cited management-related problems as the leading cause of bank and thrift failures. GAO testified that regulators frequently identified serious internal control weaknesses and violations of laws and regulations related to safe and sound operations. For example, examiners cited inadequate or imprudent general loan policies as a contributing factor in 79 percent of failed banks and over 80 percent of failed thrifts.

**186 The failure to establish and maintain effective internal controls makes banks and thrifts vulnerable to insider abuse and fraud and weakens their ability to withstand adverse economic conditions. The Committee believes it is imperative that action be taken to prevent internal control problems and noncompliance with laws and regulations from causing a repeat of the current thrift crisis. The audit and management reporting requirements prescribed by this section are critical to ensure the workability of the capital requirements and other reform provisions contained in the bill.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Current requirements

Current Federal regulations require independent full scope financial audits of all insured thrifts, but do not require similar audits of insured banks. Such audits serve as a means to ensure*282 the integrity of financial information reported to shareholders, customers, and regulators, and are an invaluable source of information on the condition of individual institutions. As such, financial audits are equally important to all insured financial institutions, not just to thrifts. A recent study, however, concluded that almost 800 FDIC-insured banks do not receive any form of review of their financial statements. Another 4,200 banks receive less than a full scope financial audit, including 13 banks with total assets greater than $1 billion. This bill will not only ensure parity between the audit requirements for thrifts and banks, but will ensure that the financial condition of insured institutions serving as custodians for large amounts of deposits is properly reported.

Management reports

The Committee's bill also expands the financial audit and reporting requirement by requiring management of each insured financial institution to report on their internal controls and compliance with laws and regulations related to safety and soundness. It also requires the independent public accountant to review and report on management's assertions.

In its review of failed thrifts and banks, GAO found that examiners cited inadequate supervision by the board of directors in 49 percent of failed banks and 73 percent of failed thrifts. Management, particularly the board of directors, has the responsibility and fiduciary duty to operate financial institutions in a safe and sound manner, which includes ensuring that the institution establishes and maintains an effective system of internal controls and complies with applicable laws and regulations.

The extent to which GAO found that the board of directors and management breached their fiduciary duties points to the need for increased awareness of this responsibility and for greater management accountability. The bill addresses this problem by requiring management to acknowledge and report on their responsibilities.

Current professional auditing standards require the independent public accountant to consider an entity's internal control structure in planning and executing an audit and to inform management of significant deficiencies. These standards also require the auditor to carefully evaluate the risk that financial statement assertions may be materially misstated because of intentional misconduct or fraud by management or employees.

**187 Current professional standards, however, do not require an assessment and report on the adequacy of an entity's internal controls or its compliance with laws and regulations. To enhance the credibility of the management reports and provide regulators with assurance that management's assertions related to internal controls and compliance with laws and regulations are accurate, the bill requires independent public accountants to report on management's assertions. Requiring independent assessment and reporting will enhance the reliability of audited financial statements, provide regulators an additional tool for ensuring the safety and soundness of the financial services industry, and fill a void in this industry's current disclosure system.

*283 Role of the FDIC

Arguments were presented that the audit and reporting requirements in this section would be burdensome and costly for small banks. However, the cost of an audit is based on a number of factors, including the condition of the entity's books and records, the market area, and the complexity of the entity's financial activities. Nevertheless, to address this concern, the bill provides that the FDIC may prescribe alternative auditing and reporting requirements for insured banks with assets less than $150 million. Therefore, nearly 12,000 of this nation's 14,000 banks could be exempt from some provisions of this section.

The bill requires the FDIC to establish the form and content of the management reports, including the laws and regula-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

tions related to safety and soundness on which management will report. In order to give the greatest practical assurance that the additional reporting duties are technically sound and may be discharged in a reasonable manner, the Committee has made express provision for private sector involvement in the development of criteria to guide management and the auditors in the conduct of their responsibilities.

To this end, a period of eighteen months is reserved before these new reporting requirements are to take effect in order to allow for procedures and criteria to be developed to direct management in the preparation of its report on internal control and compliance. With respect to the auditor's report, FDIC is directed to prescribe such rules only after public notice and opportunity for comment, and consultation with recognized auditing standards setting bodies, such as the Auditing Standards Board of the American Institute of Certified Public Accountants and the Comptroller General of the United States. The intent of the rule-making provision is to ensure consistency between each institution's reports and is not meant to require the FDIC to establish new auditing standards.

In addition, the requirement for the FDIC to identify specific laws and regulations is not meant to imply that it must prepare an exhaustive list of all State and Federal laws and regulations related to the operations of financial institutions. Rather, these provisions ensure consistency between institutions and provide the FDIC the opportunity to ensure that the management reports, and auditors' reports thereon, cover those areas which will be most useful to it and the other regulators in ensuring the safety and soundness of insured financial institutions. Nonetheless, the FDIC should identify the applicable laws and regulations with enough specificity to ensure that management, and particularly the institutions' auditors, are addressing the laws and regulations determined to be most important.

Study of the credit union system

**188 Credit Unions continue to enjoy wide public support but the Committee has a responsibility to ensure to the taxpayer that credit unions and their insurance fund remain solvent and well managed. Accordingly, in section 1202, the bill contains provisions which require the Comptroller General, in consultation with other financial regulatory agencies, to conduct a study of the structure of*284 the National Credit Union Administration, including the role of credit unions, the financial condition of the national credit union system, and the funding of the National Credit Union Share Insurance Fund. The study will also include an evaluation of credit union supervision at the State and Federal level, credit union capital levels, credit union bond issues and an appropriate structure for the offering of competitive products and services consistent with standards of safety and soundness. A report of this study shall be submitted to Congress within eighteen months of enactment.

OCC employment provision

Consistent with the intent of the Committee as expressed in this Act that each Federal banking regulatory agency must be able to attract and retain qualified staff, section 1203 provides that the Comptroller of the Currency, after consultation with the Secretary of the Treasury, has the authority to fix the compensation levels for employees of the Comptroller of the Currency. In setting and adjusting compensation levels, the Comptroller shall seek to maintain comparability with the compensation at the other Federal bank regulatory agencies.

NCUA employment provision

Section 1204 of this Act provides further expression of the Committee's intent to permit Federal financial institution regulatory agencies the ability to provide their employees with fair and reasonable compensation. In this Section, the Board of the National Credit Union Administration is authorized to fix compensation levels for that agency at levels which seek to maintain comparability with compensation levels at other Federal banking regulatory agencies.

Underutilized financial institutions

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Section 1205 is designed to promote the use of underutilized minority and women's banks, as well as limited income credit unions by requiring the Secretary of the Treasury to consult with the appropriate Federal depository institution regulatory agencies on methods for increasing the use of these institutions as depositories or financial agents of Federal agencies. The Secretary of the Treasury and each Federal financial institution regulatory agency will report to the Congress within six months of the date of enactment of this Act on the actions taken by the Secretary or the agencies pursuant to this section.

Credit Union Advisory Committee

In adopting section 1206, the Committee is noting that credit standards and the resulting lending patterns are key considerations in the determination of a financial institution's safety and soundness. As noted previously, faulty lending practices are common characteristics of most failed institutions. The Act establishes an eleven member panel, comprised of the heads, or their designees, of five Federal banking regulatory agencies and six public members selected by the President. No more than three public members may be from the same political party. The Advisory Committee shall review, prepare comment and recommendations*285 and monitor the credit standards and lending practices of Federally insured financial institutions. The Advisory Committee will submit a report to Congress no later than January 30 of each year.

Examination standards

**189 The purpose of this section is to strengthen the quality of state supervision of insured State-chartered depository institutions by establishing uniform standards and procedures for accreditation of state supervisory agencies and to set standards for State examinations of Federally insured institutions—banks, thrifts and credit unions.

The Federal Financial Institutions Examination Council, in consultation with its liaison committee (which includes State representation), shall establish minimum requirements for examinations of insured depository institutions by State depository institutions supervisory agencies, as well as for their examiners, in order for those exams to be more readily accepted by Federal insurers. The Council shall set criteria for standards, including frequency of exams, quality and thoroughness of exams, standards and procedures for classifying loans and supervising lending practices, education and training of examiners. The Council shall conduct an annual review of State supervisory agencies.

If a State fails to meet standards or does not allow for an annual review, the Council shall notify and submit a report detailing reasons of noncompliance, and may prescribe a time period in which state agencies shall come into compliance.

Federal insurers, in general, shall accept exams of financially sound insured banks (CAMEL rating 1 or 2) in States with accredited state bank supervisory agencies. The Federal insurer, however, may refuse to accept an exam of an institution in an accredited State on a case by case basis.

In order to give further incentive to States to reach the accreditation standards, following 3 years of enactment of the Act, the insurers shall begin to withhold one half of any subsequent assessment credit (premium rebate) which otherwise would be due to institutions in States not meeting the standards within that 3 year period.

This provision also provides that the appropriate deposit insurance fund will reimburse any state supervisory agency for 65 percent of the cost of training directly related to improving the technical skills of its examiners. This paragraph is intended to provide incentive to States to involve their supervisory and examination staff in quality training programs, while making the state agencies commit to the training programs because of the contribution of 35 percent of the cost.

Comparability in compensation schedules

Section 1208 of the Committee bill requires the Federal financial institution regulatory agencies to inform each other of their pay schedules and encourages them to try to accomplish general comparability of such schedules.

It is the intent of the Committee that at the outset, the other pertinent agencies will at least seek to achieve comparabil-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ity with*286 the schedules determined by the Federal Deposit Insurance Corporation. The Committee realizes that historically, the Federal Deposit Insurance Corporation has been given the adequate flexibility and independence necessary in setting compensation. By maintaining competitive compensation schedules, the Federal Deposit Insurance Corporation has been able to attract and maintain extremely qualified personnel deemed necessary to conduct each supervisory and examiner function.

**190 While the Federal Reserve Board is not specifically subject to this provision, the Committee expects that the Board will provide the Committee information on compensation schedules to assist the Committee in its oversight and legislative responsibilities.

Treasury study of bond offerings

Recognizing the importance of promoting saving and thrift among all segments of our population and, further, noting that it is proper to encourage taxpayers to participate in the REFCORP bond program they are backing with their own tax money, the Committee, in section 1209, directs the Secretary of the Treasury to study the extent to which REFCORP bonds and other U.S. Government securities in small denominations benefit and promote savings. To encourage the sale of these securities to small investors, the Secretary shall also recommend measures to expand the availability of small denomination government securities to small investors.

Limitation on use of taxpayer funds

Section 1210 provides that funds appropriated or borrowed pursuant to an authorization contained in this Act may be used only for purposes permitted in the Act and may not be otherwise used for making any payment to any shareholder in, or creditor to, any insured financial institution. It is the express intent of the Committee that nothing in section 1210 shall be construed to mean that funds pursuant to an authorization contained in the Act may not be used by an appropriate Federal regulatory agency, pursuant to its jurisdiction, to arrange or carry out the acquisition, merger or liquidation of any insured financial institution.

Separability of provisions

The final section of the title (section 1211) states that if any provision of this Act or the application thereof to any person or circumstance is held invalid, the remainder of the Act and the application of the provision to other persons not similarly situated or to other circumstances shall not be affected thereby.

TITLE XIII—PARTICIPATION BY STATE HOUSING FINANCE AUTHORITIES

State Housing Finance Authorities

State Housing Finance Authorities have proven to be effective in the effort to promote affordable housing and home ownership opportunities. The intent of this Title is to provide State Housing Finance Authorities, as defined in the Act, with the authority to purchase mortgage-related assets from the RTC or from a financial institution with respect to which the Federal Deposit Insurance Corporation*287 is acting as a receiver or conservator. The State Housing Finance Authorities will be required to invest any net profits attributable to the ownership of such assets in the financing, refinancing or rehabilitation of low and moderate income housing within the jurisdiction of such State Housing Finance Authority.

STATEMENTS MADE IN ACCORDANCE WITH HOUSE RULES

In accordance with clauses 2(1)(2)(B), 2(1)(3) and 2(1)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

COMMITTEE VOTE

(Rule XI, Clause 2(1)(2)(B))

**191 The Committee on Banking, Finance and Urban Affairs, with a quorum present, ordered H.R.1278, as amended, favorably reported by a recorded vote of 49 ayes and 2 nays at its markup on May 2, 1989.

OVERSIGHT FINDINGS AND RECOMMENDATIONS

(Rule XI, Clauses 2(1)(3)(A) and (D), and rule X, Clauses 2(b)(1) and (2) and 4(c)(2))

On January 10, 1989, the Banking Committee held hearings on FSLIC assistance programs. On January 12, 1989, the Banking Committee held field hearings in San Francisco on the examination and supervision of depository Institutions. On January 13, 1989, the Banking Committee held field hearings in San Francisco on the examination and supervision of depository institutions.

On February 9, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the "other side" of the savings and loan industry. On February 21, 1989, the Banking Committee held hearings on the failure of independent Certified Public Accountants to identify fraud, waste, and mismanagement and assure reporting of the accurate financial position of troubled savings and loans. On February 23, 1989, the Banking Committee held hearings on the Bush Administration's plan to resolve the savings and loan crisis.

On March 8, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. On March 9, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held additional hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. On March 10, 1989, the Banking Committee held a field hearing in San Antonio, Texas on the current financial condition of the bank and savings and loan insurance funds, and the need for a joint regulatory effort, especially in Texas. On March 11, 1989, the Banking Committee continued field hearings in San Antonio, Texas on the current financial condition of the bank and savings and loan insurance funds, the need for a joint regulatory effort, especially in Texas. On March 14, 1989, the Subcommittee on Financial Institutions*288 Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Reform, Recovery, and Enforcement Act of 1989.

On March 16, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's Proposed Reform, Recovery, and Enforcement Act of 1989. On March 21, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. On March 22, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the Bush Administration's proposed Financial Institutions Reform, Recovery, and Enforcement Act of 1989. On March 22, 1989, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held hearings on the adequacy of banking agency examination levels and compensation.

**192 Accordingly, the Committee recommends that the House pass H.R.1278, as amended, the bill that accomplishes the objectives reflected in these findings.

OVERSIGHT FINDINGS

The Committee was assisted by the findings of the Government Operations Committee contained in the following reports: Federal Supervision and Failure of the United American Bank in Knoxville, Tenn., and Affiliated Banks, November 18, 1983; Federal Home Loan Bank Board Supervision and Failure of Empire Savings and Loan Association of Mesquite, Texas, August 6, 1984; Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial In-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

stitutions, October 4, 1984; Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market, September 25, 1986; Combating Fraud, Abuse and Misconduct in the Nation's Financial Institutions: Current Federal Efforts are Inadequate, October 13, 1988.

ADVISORY COMMITTEE STATEMENT

(Section 5(b) of the Federal Advisory Committee Act)

Section 1206 establishes the Credit Standards Advisory Committee. The functions of the proposed advisory committee, are not, and could not be performed by any agency, by any existing advisory committee, or by enlarging the mandate of an existing advisory committee.

INFLATION IMPACT STATEMENT

(Rule XI, Clause 2(1)(4))

The Committee finds that the bill will not have any impact on any inflationary trends in the national economy.

***289** COST ESTIMATE OF THE CONGRESSIONAL BUDGET OFFICE PURSUANT TO SECTION 403 OF THE CONGRESSIONAL BUDGET ACT OF 1974

(Rule XI, Clause 2(1)(3)(C))

U.S. CONGRESS
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, May 16, 1989.

Hon. HENRY B. GONZALEZ,
Chairman, Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has not yet completed its cost estimate for H.R. 1278, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. We appreciate the efforts of the committee staff, who have provided us language as it has become available, and we understand your need to file in a timely fashion. Nevertheless, because of the length and complexity of the bill, we are unable to meet your schedule for filing the committee report. We will provide the committee with a cost estimate as soon as possible, after we have had additional time to review the final language of the reported bill.

We look forward to being of continued assistance to the committee.

Sincerely,

ROBERT D. REISCHAUER, Director.

CORRESPONDENCE RECEIVED BY THE COMMITTEE PERTAINING TO H.R.1278

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, DC, May 9, 1989.

Hon. HENRY B. GONZALEZ,
Chairman, Committee on Banking, Finance and Urban Affairs, Rayburn Office Building, U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN. I would like to thank you and the Committee on Banking, Finance and Urban Affairs for addressing the concerns expressed in my letter of May 2, 1989 regarding H.R.1278, the Financial Institutions Reform, Re-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

covery and Enforcement Act of 1989. I very much appreciate the spirit of cooperation with which our Committees were able to address those concerns. In that same spirit of cooperation, I would like to bring to your attention two remaining matters of concern to the Committee on Agriculture with regard to H.R.1278.

REAL ESTATE APPRAISAL REFORM AMENDMENTS

**193 The first concern regards the proposal contained in section 1121(b) of the text of the bill reported by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance. I would like to reiterate my appreciation to your committee for agreeing not to include this proposal in the committee amendments. I would urge you to insist on the House position in this*290 matter during the conference committee's consideration of H.R. 1278.

As I explained in my letter of May 2, 1989 (copy enclosed) section 1121(b) would have, in effect, allowed the Office of Management and Budget to extend the real estate appraisal provisions of title XI of H.R.1278 to any federal agency or department. Thus, section 1121(b) would have authorized the Office of Management and Budget to broaden the scope of title XI to include the activities of many of the agencies within the jurisdiction of the Committee on Agriculture pursuant to Rule X clause 1(a) of the Rules of the House.

Because your committee has addressed the concerns detailed in my May 2 letter, I will not seek a sequential referral of H.R.1278 to the Committee on Agriculture. However, I note that section 1411 of S. 774, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, includes a provision identical to section 1121(b) of H.R.1278, as it was reported by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance. The Senate provision, the proposed new section 1010(t)(2) of the Federal Financial Institutions Examination Council Act of 1978, as would be added by section 1411, raises the same concerns I have expressed regarding section 1121(b).

Accordingly, I would request that your committee do me the favor of insisting on the House position in this regard when this legislation is addressed by the committee of conference. If you are able to accommodate this request, I will not need to ask the Speaker of the House to name Members of the Committee on Agriculture as conferees for the consideration of title XI of H.R.1278.

GAO STUDY OF GOVERNMENT SPONSORED ENTERPRISES

My second concern is with the amendment adopted during your committee's consideration of H.R.1278 that would require the Comptroller General to conduct a study regarding the capital requirements for government-sponsored enterprises (GSE). Among the GSE's named in the amendment were two entities within the jurisdiction of the Committee on Agriculture: the Federal Farm Credit System and the Federal Agricultural Mortgage Corporation.

I am concerned that the Committee on Banking, Finance and Urban Affairs is requiring the Comptroller General to conduct a study of agencies and matters within the jurisdiction of the Committee on Agriculture. Accordingly, I appreciate your willingness to include in the report to accompany H.R. 1278 language making clear that it is not the intent of your committee to in any way alter existing precedents with regard to the Farm Credit System or the Federal Agricultural Mortgage Corporation by the adoption of this amendment or the conduct of this study. Further, I share your understanding that the Comptroller General and representatives of the GAO will consult and cooperate with the Committee on Agriculture during the conduct of this study, in light of this committee's expertise on these matters.

**194 Finally, I would request that a copy of this letter, along with a copy of my letter of May 2, 1989, be included in any report on the*291 Financial Institutions Reform, Recovery and Enforcement Act of 1989.

Thank you again for your cooperation in addressing these issues of concern to our respective committees. I look forward to continuing the cooperative working relationship between our committees in the future.

Sincerely,

E (KIKA) DE LA GARZA,
Chairman.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, DC, May 2, 1989.

Hon. HENRY B. GONZALEZ,
Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: I am writing to express my concern regarding a provision in title XI of H.R.1278, regarding real estate appraisals.

Title XI of H.R.1278, as reported by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, would require the use of State certified or licensed appraisers for real estate related financial transactions engaged in, contracted for, or regulated by certain named federal financial institutions regulatory agencies, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Resolution Trust Company.

I am particularly concerned with section 1121(b) of H.R.1278, which would allow the Office of Management and Budget (OMB) to extend the provisions of title XI to any federal agency or department. This provision, in effect, would allow OMB to broaden the scope of title XI to include activities by many of the agencies within the jurisdiction of the Committee on Agriculture, including, potentially, farm real estate and community facility loans made or guaranteed by the Farmers Home Administration, real estate sales and purchases by the U.S. Forest Service, real estate lending by the Rural Electrification Administration, farm real estate lending by the Farm Credit Banks and Federal Land Bank Associations subject to the regulation of the Farm Credit Administration, farm real estate mortgages guaranteed by the Federal Agricultural Mortgage Corporation, and many other real estate transactions regulated by or involving the Department of Agriculture itself.

The above mentioned agencies are within the jurisdiction of the Committee on Agriculture pursuant to Rule X, clauses 1(a)(2), (12), (13), (17), and (19) of the Rules of the House. The provisions of title XI would have far-reaching effects on the operations of these agencies with regard to their real estate lending, sales, purchasing and appraisal practices, which are already governed by considerable statutory requirements. It is unclear how the provisions of title XI of H.R.1278 would affect these current statutory authorities and the practices of these agencies. The Committee on Agriculture has not had an opportunity to study how the provisions of title XI ofH.R.1278*292 would affect these agencies, nor have any of these agencies had an opportunity to testify as to their concerns regarding this legislation.

**195 Accordingly, I believe the responsible course of action at this time is to delete section 1121(b) from H.R.1278. This would allow the Committee on Agriculture the opportunity to assess the impact which title XI's provisions may have on the many agencies within the Committee's jurisdiction, and to determine the desirability of enacting legislation in this regard at the appropriate time.

Mr. Chairman, I understand completely the importance to our nation's financial system of the many other issues addressed in H.R.1278, and the task you face in seeking solutions to these issues. However, if section 1121(b) remains in the bill, I will assert the Committee on Agriculture's jurisdiction in this matter and seek a sequential referral of H.R.1278.

I would hope that our respective committees can work together to find a mutually acceptable solution to this problem, as we have many times in the past.

Sincerely,

E (KIKA) DE LA GARZA,
Chairman.

ADDITIONAL VIEWS OF MR. ANNUNZIO, MR. KANJORSKI, AND MR. FLAKE

The treatment of supervisory goodwill in H.R.1278 will have adverse consequences for hundreds of savings and loans, for the United States government, and for the American taxpayer. It will raise the cost of resolving the savings and loan crisis, not only by forcing institutions into solvency, but also as a result of litigation over whether the Congress has au-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

thorized a taking under the due process clause of the Fifth Amendment for which the United States is liable for damages.

The Committee's action is the same as the government asking a man to enlist in the Army for hazardous duty overseas and then suing him for deserting his wife and children.

THE NEED FOR MORE CAPITAL

I recognize the need for higher levels of capital in the savings and loan industry. Clearly, owners of savings and loans must have their own money standing in front of the Federal government's deposit insurance. It was for that reason that I sponsored the capital requirements that were adopted by the Financial Institutions Subcommittee. Those requirements would have required three percent core capital. That capital would have been real capital. Institutions with supervisory goodwill would have been allowed to count it toward up to one half of the core capital requirement.

Contrary to some misleading reports, this provision was far tougher than either existing law or the Bush Administration proposal. It was the first proposal to require savings and loans to have tangible capital, and it required it a full year earlier than when the Bush proposal capital standards would have gone into effect. ***293** Nevertheless, it was attacked as being too lenient. Ironically, when the Senate subsequently adopted similar standards, they were praised for their strength.

SUPERVISORY GOODWILL

I believe that supervisory goodwill is one of the most misunderstood issues in this legislation. Supervisory goodwill was created during the 1980's because FSLIC did not have the resources to close or merge failed or failing institutions. Rather than face up to the fact, FSLIC embarked upon a campaign to convince healthy savings and loan to acquire unhealthy institutions without Federal assistance. Healthy institutions agreed to do so, thereby relieving the United States of the cost of resolving the failing institutions.

****196** Supervisory goodwill represents the difference between the value of the assets and liabilities of the failed institutions. The acquiring institutions accepted this burden, without any compensation in the form of cash or notes to make up the difference. In short, the acquiring savings and loans agreed to make up the shortfall out of their own pockets. They did not receive financial assistance, as acquirers of failed savings and loans received last year, but only a promise from the Federal Home Loan Bank Board that they could carry the supervisory goodwill on their books.

Supervisory goodwill is not carried as a permanent asset. It is amortized, or written off over a specified period. Every year savings and loans with supervisory goodwill expense a portion of it. To cover this expense, an institution must earn a profit on its other assets. Supervisory goodwill is not a benefit for institutions, but a burden.

Institutions acquired about $23 billion in supervisory goodwill in the last decade. This represents the negative net worth of the institutions that were acquired, a cost that the acquiring institutions agreed to accept in lieu of receiving cash or notes from FSLIC. By taking goodwill rather than insisting that FSLIC make up the negative net worth, the loss to the insurance fund was shifted to the acquiring institutions. They still have about $18 billion in supervisory goodwill on their books. To date, then, those institutions have absorbed $5 billion in negative net worth through reduced earnings, an amount that otherwise would have been paid by FSLIC. In the coming years they will have to absorb the remaining $18 billion.

PUNITIVE TREATMENT OF SUPERVISORY GOODWILL

Unfortunately, section 314 was amended by the Full Committee to phase out the treatment of goodwill for capital purposes over a five year period. Simply put, the Committee has reneged on the agreements that the government entered into concerning supervisory goodwill.

The institutions would have been foolish to agree to accept supervisory goodwill if they had known that Congress

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

would change the rules of its treatment. Clearly, the agreements concerning the treatment of goodwill were part of what the institutions had bargained*294 for. Just as clearly, the Committee is abrogating those agreements.

Under contract law, the institutions would have a right to sue for breach of contract. While the government has the power to abrogate contracts it enters, it still may be liable for breach of contract damages. Even if it were immune from a breach of contract suit, it may be liable under the Fifth Amendment of the Constitution for a taking. It may be able to take contract rights from the institutions with supervisory goodwill, but at the same time it may be liable to them for just compensation under the Due Process clause of the Fifth Amendment.

The constitutional issue is admittedly a difficult one. That fact alone makes it likely that the issue will not be resolved until the Supreme Court has had an opportunity to rule on it. That means years of expensive litigation, and significant uncertainty until the Court has rules on the issue. The Committee would have been wiser to maintain equitable treatment for supervisory goodwill so as to avoid unnecessarily raising the Constitutional issue.

UNFAIRNESS CREATES UNCERTAINTY

**197 The United States not only has a moral and legal obligation to keep its word, but a practical reason as well. Over the next several years, the government will be looking for new investors for hundreds of insolvent banks and savings and loans. Those investors are sure to remember the punitive treatment that those institutions which relied on the government's word concerning supervisory goodwill received, and the cost of future resolutions will be adjusted upward accordingly. The taxpayer will bear the burden created by this Committee, and receive nothing in return.

CONCLUSION

The treatment of supervisory goodwill by the Committee is unfair, unwise, and costly. It does not strengthen the savings and loan industry. On the contrary it weakens those institutions which voluntarily tried to help resolve the problems of the industry. In the long run, higher costs and more failed institutions will be the unnecessary result.

FRANK ANNUNZIO.
PAUL E. KANJORSKI.
FLOYD H. FLAKE.

*295 ADDITIONAL VIEWS OF CONGRESSMAN HUBBARD RELATING TO HUBBARD–NELSON LOW–INCOME AMENDMENT, SECTIONS 209 AND 312 OF H.R.1278

In the deliberations leading to the reported legislation, I sponsored provisions, now included in Titles II and III of the bill, relating to the financing by savings associations of low-to-moderate income housing. The provisions are intended to maintain, and were possible enhance, the role of savings associations in the effect to satisfy the nation's critical need for such housing. Unfortunately, the economic crisis in the savings industry has created incentives for savings associations to abandon low-income housing lending for other more profitable investments. The provisions to are designed in part to curb that trend.

The principal focus of the Committee in this legislation, quite property, has been on issues unrelated to low-income housing, such as stronger regulation of savings associations and recapitalization of the insurance fund. While I agree with that focus, I believe it ought not cause us to lose sight of the importance of the savings industry to low-cost housing. Accordingly, I sponsored sections 209 and 312 of the bill, which provide that low-cost housing lending is a factor to be considered in fundamental regulatory decisions regarding individual savings associations.

Specifically, these two sections are intended to provide that government regulators consider, as an important factor, the extent of an association's low-to-moderate income housing loans in deciding whether to terminate insurance or establish a conservation or receivership for an institution that is solvent under regulatory accounting principles. The regulators

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

should use every means at their disposal to assist associations with significant levels of low-to-moderate income housing loans in their portfolios, rather than shut them down. The nation's need for low-income housing is simply too great to ignore any legitimate means—including the provision of open bank assistance where appropriate—to keep in operation associations with a proven pattern of low-income lending.

**198 The reported legislation is designed to put the savings industry and deposit insurance bank on a sound financial path. One of the most important justifications for the high price to be borne in meeting that goal is the continued availability of savings associations that meet our nation's housing lending needs. The provisions I sponsored are intended to ensure that government regulators do not ignore those needs when considering important regulatory decisions under the legislation. Rather, the regulators should keep those needs clearly in mind and make every effort to accommodate them where possible.

CARROLL HUBBARD.

*296 ADDITIONAL VIEWS OF CONGRESSMAN HUBBARD ON SECTION 402 OF H.R.1278

When this legislation was under consideration by the Committee, the Committee faced the daunting task of balancing the funding needed to resolve problem thrift cases with a legitimate need to reform the thrift industry to assure that there is no repetition of the problem. The approach we have taken strikes a proper balance in that capital rules are very stringent and the enforcement powers of the agencies are significantly enhanced. I see no need to go further in these areas since the thrift industry may already be paying more than it can safely fund while still serving the vital home mortgage finance requirement for which it was created.

One amendment which I introduced was designed to permit the insurance of accounts rules of the FSLIC to continue to treat deferred compensation plans of state and municipal employees to continue to be insured. Section 1005 of the bill requires the FDIC to conduct a study over an 18–month period on a variety of insurance issues, including exploration of the issue of bank insurance contracts and whether they should be insured deposits. The study is useful. I believe, however, that it is imperative that the study be confined to issues in which there has not been significant business activity already. In particular, I am concerned that my amendment which provides that the FSLIC treatment of deferred compensation plans under Section 457 of the Internal Revenue Code for state and municipal employees not be adversely affected by the study. My amendment would assure that these programs continue with the same insurance of accounts treatment that they currently enjoy, i.e., $100,000 per beneficiary. These programs have encouraged savings and provide an important retirement benefit for a segment of our workforce which does not enjoy many such benefits. I believe the insurance treatment should continue as set forth in the FHLBB rules since 1982.

CARROLL HUBBARD.

*297 ADDITIONAL VIEWS OF CONGRESSMAN JOHN J. LaFALCE

While I voted in favor of the legislation as amended by the Committee, I continue to have very serious reservations about several aspects of the President's proposal. It is my hope that Congress can effect further improvement in the legislation as the bill moves forward.

**199 In our rush to judgment on this legislation, I fear that we are losing sight of what should be some of our primary goals—to minimize taxpayer costs and ensure an equitable sharing of the burden. Judged by these two standards, the President's plan simply does not measure up.

In my view, there continue to be four major problems with the President's plan which have been adequately addressed to date: (1) the cost estimates for resolving problem thrift cases are deceptively low; (2) the bonding mechanism is both fiscally irresponsible and morally reprehensible and will significantly increase the costs to the American taxpayer; (3) the alleged burden sharing is inequitable—the taxpayer contribution is significantly understated, the industry contribution is overstated, and other legitimate sources of income such as the states are not tapped; and (4) the application of the capital

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

standards treats institutions inequitably and may ultimately increase the cost to the taxpayer.

I. THE COSTS

The Administration cites the overall cost of the plan at approximately $90 billion. But, the cost estimates are understated and the economic assumptions that underlie them, overly optimistic.

An analysis provided by the House Banking Committee staff suggests that the total cost of the Administration plan, before subtracting estimated revenues, will be approximately $335 billion, including the cost of the financing corporation (FICO and REFCO) bonds, FSLIC notes, assistance agreements, guarantees, future assistance and purchase of zero coupon bonds.

There is are several reasons that the Administration's estimate is so low. First of all, the Administration's plan calls for the issuance of 30–year REFCO bonds. However, the Administration has largely focussed on present value costs and paid too little regard to the interest over time on the additional debt we are incurring. This understates the real cost.

In contrast, Committee staff projections are based on the assumption that the new REFCO bonds, like the earlier FICO bonds, will be based on a 30–year schedule. Under the plan, the interest costs over time fall primarily on the taxpayer. It is this cost that will be a continuing drain on the average citizen and our economy, and that will necessitate additional constraints on spending for other important government programs.

***298** Secondly, under the Administration's plan the taxpayer assumes the bulk of the responsibility for the costs associated with past FSLIC transactions. The Administration caps the cost of the deals already put in place at $40 billion. Yet GAO suggests that these costs will amount to at least $70 billion when interest, subsidies and other guarantees are included. Moreover, the cost estimates on the guarantees continue to rise.

There has been minimal cash outlay in past FSLIC-assisted transactions. The money "spent" largely takes the form of FSLIC notes and other guarantees that represent the government's contribution. Long-term special assessments will be eliminated within a shorter time frame. Taxpayer vulnerability for these past "expenditures" will therefore inevitably be greater.

****200** The issue of full faith and credit on the FSLIC notes and guarantees has never been resolved. The President's plan resolves that issue by making the U.S. taxpayer the ultimate backstop for costs associated with past deals.

Third, the resolution costs the Administration estimates and the premium income it anticipates from institutions which remain operating are based on the assumption that there are approximately 500 institutions in the pool of insolvents the government must handle. Yet, several hundred more institutions may move into that pool as they prove unable to bear new financial burdens imposed and meet new capital requirements. The pool of cases to resolve will ultimately be larger and the number of remaining institutions supposed to sustain the anticipated premium inflow from industry much smaller. As a result, the projections of costs and industry contributions are highly questionable.

Finally, the Administration makes some highly unrealistic assumptions regarding interest rates, deposit growth, asset recovery, and the timetable for case resolutions. All of these optimistic assumptions have the effect of understating the cost to the taxpayer.

II. THE SHARING OF THE COST BURDEN

A. THE BONDING MECHANISM

Not only will the Administration's Plan cost more than it says, it will cost more than is necessary. Much debate has focused on whether the funding for the thrift bail-out should be on or off-budget. While a valid issue, that debate misses the most important point.

The central question is whether we should rely on the issuance of long-term bonds to fund this massive bail-out. In my view, bonding under these circumstances is not only fiscally irresponsible but morally reprehensible. To avoid coming to

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

grips with some tough realities, we are passing the costs of this bail-out—far higher costs than would otherwise be necessary—on to our children and grandchildren.

The President and the Congress are deciding to spend an additional $40–50 billion over the next three years. We will, therefore, be spenders. The issue is, will we spend and tax, or spend and borrow and eventually tax. In this context, I believe it is far more appropriate and morally defensible to tax ourselves rather than our children.

*299 Bonding is appropriate for the funding of capital expenditures—investments in the future. Fiscal responsibility dictates that we not bond to cover present consumption, and certainly not to cover past consumption, which is exactly what we are doing here. The bonding mechanism suggested under the President's plan is a much higher cost solution than a direct infusion of funds. The difference in cost between a direct appropriation and the bonding mechanism could be as much as $150 billion over the 30–year period. It is the American taxpayer who will bear these costs.

Why, then, has bonding been proposed? This financing gimmick will allow us to keep the costs "off-budget", to solve an enormously costly problem largely with taxpayer funds while still giving the illusion that money is not being spent and taxpayer resources are not being tapped. The costs are real, and they should be acknowledged as such.

**201 The industry, the regulators, Congress, the Administration, and the states share the blame for this crisis. We should now pay for our past mistakes. It is fundamentally unjust to require future generations to pay instead. While an approach that would rely on taxes would involve some short-term pain, it would save the American taxpayer $150 billion over the 30–year life of the bonds.

The Administration repeatedly invokes the need for fiscal discipline to support its decisions to utilize a bonding mechanism and to keep the costs off-budget. But, in my view, we have surely failed in our effort to achieve fiscal discipline if we "comply" with Gramm–Rudman and the demands of other industrialized countries for U.S. fiscal discipline by devising financing gimmicks to hide real costs.

We must also be attentive to how the proposed bond issuance might increase the degree to which government borrowing (or something closely akin thereto) crowds out other borrowers in U.S. capital markets. Other borrowers are already disadvantaged in our capital markets because of the high level of government borrowing. The REFCO bonds will fuel this problem. Increasingly greater amounts of money that could be turned toward productive investment will be deflected toward ongoing debt repayment.

B. THE RELATIVE BURDEN ON THE INDUSTRY AND THE TAXPAYER

The President has rightly suggested that the thrift industry and the taxpayer share the burden of the overall costs. However, I believe the projections as to what the industry can and will contribute over time are unrealistic. Hence, I believe the taxpayer will bear the most significant portion of these costs.

First of all, the ability of the industry to contribute depends on the continuing viability of a substantial portion of thrift institutions. Moreover, the Administration assumes a deposit growth rate of 7% and no further disintermediation in calculating premium income. Both of these assumptions are unrealistic, particularly because a significant portion of the disintermediation we are seeing is simply a function of rate differentials.

The plan locks even the healthiest thrifts that could effect a transfer to the FDIC into the FSLIC system for five years, gives them a seal that will mark them as second class citizens, increases their premium costs, and leaves them with a permanent disadvantage*300 in terms of premium costs vis-a-vis commercial banks. This will not make them very attractive to either investors or depositors.

It is hard to avoid the conclusion that healthy thrift institutions are being locked into a system so that their alleged resources can be depleted to re-fund the FSLIC fund. Few of these institutions may make it. Yet the plan counts on the premium inflow from surviving institutions as a major source of funds.

Secondly, the costs to the industry under the President's plan are fixed, while the taxpayer costs are indeterminate. Under the plan, the industry must contribute approximately two and a half billion dollars in retained earnings and $300 mil-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

lion annually. Whatever costs are not covered by this industry contribution become a taxpayer obligation. Wherever under the plan there is a hole of questionable size, it is taxpayer money that must ultimately fill it.

**202 Costs associated with past transactions beyond the ability of FSLIC to subsume are to be picked up by the taxpayer. If interest rates are higher, or deposit growth is lower, than anticipated, taxpayer money will fill the void. If additional bond issuance is necessary, the taxpayer will bear principal and interest costs. If a number of additional institutions move into insolvency and premium inflow into the new fund is less than anticipated, the taxpayer will pick up the tab. The burden on the industry is heavy, but fixed. The taxpayer is being asked to proffer a blank check.

Once a bonding mechanism is in place, necessity may eventually dictate that higher and higher levels of bond issuances, funded by the American taxpayer, be approved. If there is to be a taxpayer contribution, it should be precisely fixed now and the source of funds identified.

C. THE RESPONSIBILITY OF THE STATES

It was to a significant degree state-chartered institutions with a very broad array of powers operating under lax state supervision—that were nonetheless federally-insured—that broke the federal insurance fund. As a result, we are now engaged in a fundamental restructuring of our financial services system involving massive federal assistance. We have a dual banking system and it is that system that we are bailing out. The states have obligations as well as rights under that system; and the duality of that system should be reflected in some sharing of the costs.

It is true that the federal government has an obligation to both state-chartered and federally-chartered institutions—the provision of insurance to depositors within legally prescribed limits. But, in the context of the Administration's plan, we are not for the most part talking about liquidating institutions and paying off depositors. The Administration will be relying heavily on mergers and acquisitions to work out this problem. In effect, we are engaged not in a depositor pay-off, but in a massive restructuring effort designed to preserve institutions and stability of communities. The states and the federal government should share responsibility for that effort.

The President's plan involves not only a massive bail-out, but a massive transfer of resources from the Northeast and Midwest to*301 the Southwest. The Northeast–Midwest region is responsible for less than 10% of the estimated total cost of FSLIC resolutions, but would pay 45% of the tax portion of the bail-out package. Over 80% of the FSLIC case resolutions and stabilizations in 1988 were in Texas, Oklahoma and California. Over 90% of these case resolutions were generally in the South and West; less than 10% were in the Northeast–Midwest.

There must be some regional equity in paying the costs of this bail-out. Certainly, the federal regulators are culpable, and federal taxpayers will certainly bear the largest portion of this burden. But where lax supervision by state regulators of state-chartered institutions contributed to the problem, the states involved should make some contribution to the solution.

**203 There is precedent for such a cost-sharing approach. Conditionality has been a key component of previous government bail-outs. Those benefitting the most directly paid a portion of the price. In the Chrysler bail-out, for example, all those with an economic interest participated in the cost of the bail-out.

III. THE CAPITAL REQUIREMENTS

A. THE IMPORTANCE OF TOUGH STANDARDS

The capital requirement is the crux of this legislation. If the American taxpayer is forced to make a significant contribution to the thrift industry bail-out, the imposition of tougher capital and accounting standards on the industry which will ensure this will never happen again must be a necessary quid pro quo. All of the capital proposals under discussion will impose a tougher capital standard on the thrift industry.

We are in the situation we now face largely because institutions were able to gamble on risky investments with taxpay-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

er dollars, in the form of federal deposit insurance, backing them up. In such a situation, the investor realizes any gain, but the government—and the taxpayer—bears any loss.

Investors will be more prudent only if they have their own funds at risk. Experts who have analyzed thrift industry problems point out that those institutions with positive net worth have, as a group, positively improved their position during the 1980's. In contrast, those with no or mimimal positive net worth have deteriorated further.

Private capital is the appropriate buffer between the industry and its insurance fund and the best protection for the taxpayer. We must ensure that savings institutions have a real cushion to fall back on.

B. THE EQUITY ISSUE: THE NEED FOR A TRANSITION RULE

While I strongly believe in tough capital requirements, I do not believe that we can now wipe the slate completely clean in one quick stroke without doing unnecessary damage to viable institutions and increasing taxpayer costs. The tangible capital requirement we are considering will be a new requirement for the thrift industry, and it is an appropriate one—but it cannot be met overnight.

***302** In particular, in the early 1980's, numerous healthy institutions took over failing institutions at the behest of the Bank Board. Then, as now, FSLIC had no money to contribute in these assisted transactions. The Bank Board did not then view it as being within its authority to issue an enormous volume of FSLIC notes. As a result, the Bank Board permitted acquiring institutions to count intangible assets—most often supervisory goodwill—on their books in exchange for the money FSLIC could not contribute. These institutions acted in reliance on a government commitment and, in effect, bailed out an under-funded FSLIC. The rug should not now be pulled out from under them.

The inequity of the failure to provide some reasonable transition rule for these institutions becomes even clearer when we examine the 1988 FSLIC-assisted transactions. Under the Southwest Plan, the Bank Board "resolved" the problems of numerous hopelessly insolvent thrifts in the Southwest. In most cases the technique was similar to that used in the early 1980's—the Bank Board located an acquiror for the ailing institution. Again, FSLIC had no cash to contribute. But this time the Bank Board did not grant supervisory goodwill—it issued FSLIC notes. Institutions holding those notes will now be in a position to meet the new capital standards. Institutions with supervisory goodwill on their books will not.

****204** Some accommodation must be made for potentially viable institutions that will be unable to comply as quickly with the new capital standards because of their past participation in FSLIC-assisted transactions. Certainly, we want tough standards—but those standards must be fair and reasonable as well. It is in no one's interest to throw viable institutions into the pool of insolvents that must be handled with taxpayer money.

C. THE IMPACT ON THE TAXPAYER CONTRIBUTION

The capital requirements will inevitably affect the size of the taxpayer contribution under the Administration's proposal. Thrift institutions must meet far more stringent capital requirements within two years under the President's proposal, within one year under the House Banking Committee's bill. The likely result is that many of the now salvageable institutions will move into insolvency.

The larger the pool of insolvent institutions, the higher the taxpayer contribution will be. The $50 billion cost that the President has estimated is based on resolving the problems of approximately 500 insolvent institutions. In fact, it is already a low estimate given this current number of insolvent institutions. If we drive more institutions unnecessarily into insolvency that cost must be higher still.

Moreover, institutions pushed into insolvency are in no position to contribute the premium income which is a major source of the alleged industry contribution under the President's plan. It is the American taxpayer who will bear the increased cost—a far greater cost than anyone is presently contemplating.

There may be additional costs to the government as well. Those institutions which carry intangible assets on their books do so generally under written agreements they have entered into with the***303** U.S. government, agreements which

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

generally state that they cannot be superseded by subsequent regulations. It is a fundamental principle of law that damages are in order when a contract is breached, and those damages may well be more onerous where the contract was induced by the government.

These institutions can—and will—sue, at great cost to the government interms of court costs and potential damages. Stockholder suits may also be in order. In many cases, a thrift stock institution issued a prospectus describing the thrift's capital position in accordance with the standards approved by the Bank Board. The SEC approved such solicitations. Stockholders who invested based on these representations may well have a right to recover for the inevitable loss they will incur from a drop in stock prices if the institution is found to be out of compliance with the new capital standards.

We face enormous additional costs to the government and years of entangled litigation. As that becomes more apparent, we may well wish we had introduced some modest and equitable flexibility into the capital requirements from the start.

D. SANCTIONS

There is also a continuing problem that exists in regard to sanctions for failure to comply with capital standards. The Administration has long argued that the 1991 capital compliance deadline put forward in its proposal is not a cliff. Failure to meet the deadline was not to prompt liquidation, but growth contraints. In the course of Congressional debate, the focus has also been on growth limitations as the appropriate remedy should institutions be unable to comply with new capital standards in the time frame agreed upon. But, under the President's proposal far more than growth constraints would have been allowed.

****205** Institutions not in compliance would not only have had growth limitations imposed, but would also have been subject to an array of legal and operational constraints that would have an immediate impact on an institution's viability and profitability—a judgment that the institution is operating in an unsafe and unsound manner, and the possibility of cease and desist orders, consent decrees, forced mergers or a shift in management.

Where an institution is demonstrably operating in an unsafe and unsound manner, such safeguards should come into play. Such a judgment should not be automatic, however, simply because an institution does not meet the deadline for complying with capital standards, particularly if it is an institution with good management and good prospects. In such cases, the imposition of growth limitations, coupled with demands for annual improvement in the institution's capital position, is the appropriate remedy.

The legislation must provide more clarity regarding precisely what happens to institutions that do not meet the capital standards. We cannot rely on unfettered regulatory discretion. An amendment accepted by the Committee attempted to set clearer parameters on sanctions. But the burden of proof remains on the institution to avoid and automatic finding of "unsafe and unsound" ***304** operation if it fails to meet capital standards in a timely fashion. That burden belongs on the regulator.

JOHN J. LAFALCE.

ADDITIONAL VIEWS OF HON. RICHARD H. LEHMAN ON H.R. 1278

The Committee bill is one of the most significant pieces of legislation we have ever considered, and every member should be proud of our handiwork. Nevertheless, there is one provision which needs to be perfected further, so that it does not inadvertently become a source of problems that could threaten the workability of the bill. I refer to the restrictions on the conduct of direct investments by savings and loan associations.

In crafting this legislation, the Committee has, among other important issues, considered the subjects of both capital and investment authority, to ensure that safeguards relating primarily to the former adequately address the preceived risks to the deposit insurance funds associated with the latter. The Committee has been uniform in agreeing that safeguards are appropriate. However, the nature and extent of such safeguards have been a topic of extended debate within

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

the Committee. Although I support this legislation, I remain concerned about the appropriateness of the safeguards which it would apply to direct investment activities of thrift institutions.

As the bill now stands, the Committee, in its enthusiasm for ensuring that direct investments can never endanger the deposit insurance funds, would impose all of the following restrictions:

Require savings and loan associations to comply with risk-based capital standards designed to determine the adequacy of capital in the context of the full range of an association's activities;

**206 Require that direct investments be conducted through separately apitalized subsidiares;

Require savings and loan associations to meet fully phased-in capital requirements four years prior to what would otherwise be the required date;

Authorize the Federal Deposit Insurance Corporation to prohibit by general regulation any class of direct investment activity deemed to pose a significant risk to the affected deposit insurance fund; and

Require the amount of investment in, and the specific activities of, each such subsidiary of a state-chartered association be approved by the FDIC before an association may engage in any direct investment activity other than those permitted for federal associations or national banks.

Any one of these safeguards would be adequate by itself to do the job. The cumulative effect of all of them, however, may be to prevent strongly-capitalized, well-managed associations from engaging in prudent, profitable activities.

I do not believe that the Committee intended to go so far as to prevent sound institutions from pursuing activities that can generate*305 the profits they need to meet and to maintain the very capital standards established under this bill. The safeguards should be judged in the context of an objective assessment of the risks which they are intended to address.

Studies by the Federal Home Loan Bank Board, required to be submitted to Congress under the Competitive Equality Banking Act of 1988, concluded:

Direct investments appear to explain only a relatively small portion of the total losses associated with failed savings and loan associations;

Generally speaking, losses on direct investments appear to explain only a fraction of the negative net worth of supervisory cases resolved by the FSLIC during 1988;

Well-run savings and loans have done relatively well with direct investments; and

Institutions that increased their direct investments after the adoption of Bank Board regulations have done relatively well.

Based upon these observations and data, further debate and discussion of the relationship between capital and direct investment authority, and of the risks attendant to prudent and profitable direct investments by well-managed, well-capitalized institutions is needed to make sure that the safeguards on direct investments do not become an impediment to the achievement of the larger purposes of this enlightened legislation.

One of the principal strengths that the bill can boast is that it establishes sound capital standards for the thrift industry. A risk-based standard with a three percent tangible capital requirement is a significant achievement of which Congress can be proud, given that no tangible capital standard was provided for in the administration proposal.

This standard requires institutions to maintain adequate capital in the judgment of thrift and bank regulators to support the diverse activities in which they may engage. The flaw in the legislation is that many of the activities in which institutions have participated, and which could be prudently conducted under a risk-based system, have been prohibited by the bill. Many of these activities have proven to be significant income generators for well-managed, well-capitalized institutions.

**207 At a time when capital is more important than ever to bring this industry back to a healthy condition, it appears to be incongruous to limit the options of well-managed thrifts that must meet the fully phased-in capital requirements.

The basic scheme of this bill is to subject savings and loans to capital standards no less stringent than those applicable to national banks. Presumably, this policy is based on the assumption that national bank standards are stricter than savings and loan standards, or more precisely, will be stricter, since the national bank standards have not been adopted yet.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

This is a particularly anomalous course to take with respect to savings and loans. The wisdom of putting pressure on savings and loans to become banks is questionable, given the existing oversupply, but if state-chartered savings and loans are to be converted into banks, why not at least permit them to be treated as state-chartered banks, as long as they*306 are well capitalized and well managed? No fewer than twenty-three states permit banks to invest directly in real estate.

Among the arguments that opponents of direct investments have made is that these activities are (1) outside the scope of activities proper for specialized mortgage lending, (2) excessively risky, and (3) inappropriate to be conducted with insured deposits.

Direct investments can be complimentary to a specialization in mortgage finance. The profits from direct investments can enable an institution to remain in the mortgage lending business by offsetting the shrinking margins available there with the higher profits an institution can earn by extending its underwriting expertise to such related activities as community development. Restriction of the industry to mortgage lending will offer no long-term benefit to housing if the institutions are not around to maintain their involvement. It is better to have a live institution with a ten percent housing commitment than an insolvent one with eighty percent.

The allegation that direct investments are risky implies that if an institution will follow a prescribed, supposedly conservative formula, it will achieve safety, if not profitability, over the long term. The real work of business is more complex. By the time an activity is widely recognized to be safe, so many competitors have entered the business that it is no longer profitable. Many institutions can maintain the appearance of profitability only by exposing themselves, and ultimately the taxpayers, to imprudent interest rate risks. One seasoned observer of the thrift industry recently made the following assessment of the outlook for mortgage lenders:

> The basic thrift operations strategy—gathering savings in order to originate permanently finance home mortgages—is widely viewed as obsolescent. In the past, when very few people and institutions wanted to hold mortgages, at least in the form of whole loans, the thrifts performed an essential warehousing service, for which they were compensated with mortgage rates that were higher than they otherwise would have been.
>
> **208 The advent of mortgage securitization profoundly changed the nature of the thrift business. As the public and institutional demand for the new mortgage-backed securities burgeoned, the warehousing service performed by the thrifts became increasingly redundant, and the compensation for this service declined.
>
> This was reflected in a fall in the home mortgage rates, relative, that is, to rates on other financial instruments. By the mid '80s, relative mortgage rates had fallen so much that the cost of the money thrifts had to borrow to finance their home mortgage holdings exceeded the true return on these assets—which is, in fact, the root cause of the real thrift crisis. (Emphasis ours.)
>
> Sanford Rose, American Banker, May 2, 1989.

At the conclusion of the hearings of the Senate Banking Committee on the companion bill, Ernest Fleischer, CEO of Franklin Savings and Loan Association, Ottawa, Kansas, pointed out that if interest rates had moved up instead of down in the early '80s, the real estate speculators would have done well, and the mortgage*307 speculators would have needed a bailout. It may turn out that while both direct investments and mortgages are risky, direct investments may be less so, because at least they have upside potential. Direct investments indeed contain an element of risk, and this accounts for their profitability, but in combination with traditional activities, they can provide needed diversification and serve as a truly conservative vehicle.

A related rhetorical point has been made that either because they are not residential mortgage loans or because they are risky, direct investments are not appropriate investments to be made with insured deposits. It is easy to lose sight of the fact that every activity that is conducted by a depository institution is done with insured deposits. Therefore, a profitable activity is to be preferred over an unprofitable one. Now that the Committee has adopted strict capital and supervisory standards, the taxpayer will be insulated from the consequences of those investments of all types that turn out poorly, but the entire financial system can, and must, reap the benefits of the profitable activities of well-run institutions.

I urge my colleagues to support responsible adjustments in the legislation that will enable sound institutions to parti-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

cipate fully in the recapitalization of the troubled savings and loan industry, from which not only the industry, but also the taxpayers, will benefit.

RICHARD LEHMAN.

*308 ADDITIONAL VIEWS OF HON. PAUL E. KANJORSKI, HON. MARY KAPTUR, HON. TOBY ROTH, HON. JOHN J. LAFALCE, HON. ELIZABETH J. PATTERSON, AND HON. PETER HOAGLAND

FAIRNESS TO THE TAXPAYER

While there is much of merit in this legislation we believe it is seriously flawed in one critical area—the manner in which the bailout is financed. Since the American taxpayer is being asked to pay hundreds of billions of dollars to finance the bailout, it is imperative that all those who are responsible for the problem be made to pay for the cleanup. Certain states permitted their state-chartered thrifts to engage in excessively risky activities and failed to adequately regulate those activities. We believe these negligent states must be required to shoulder a fair portion of the cost of the bailout.

THE COST OF THE CLEANUP

**209 Cleaning-up the problems of the thrift industry will not be cheap. We frequently hear references to $50 billion worth of Resolution Financing Corporation (REFCO) bonds, or a $157 billion, ten-year, bailout bill. Unfortunately, these figures are only the tip of the iceberg. They fail to take into account costs incurred under previous legislation (the FICO bond program), the full thirty year costs of the REFCO and FICO bonds, the costs associated with notes issued by the FSLIC in 1988, and the costs associated with assistance agreements and guarantees entered into by the FSLIC in 1988.

The Banking Committee projects that the full thirty year cost of cleaning-up the thrift industry is $335 billion.

Past (pre–1988) case resolutions:	Billions
FSLIC notes	$20
Interest on FSLIC notes	20
Other assistance agreements and guarantees	30
Future (post–1988) case resolutions:	
S & L assistance	80
Bond purchase and interest costs:	
FICO bond interest	30
REFCO bond interest cost	150
Purchase of zero coupon REFCO bonds	5
Total costs over 30 years	335

To put this cost in perspective, the entire Marshall Plan to rebuild Europe cost only $13.3 billion. We spent significantly more than that last year alone just bailing out state-chartered thrifts in Texas, and American taxpayers will spend even more in the years to come.

According to the GAO, the cost assumptions built into the Administration plan are optimistic. The GAO believes it is "unrealistic"*309 to expect that the ultimate costs will be lower. It further notes that "there are several factors that could serve to increase the costs," including: higher than expected interest rates, recession, slower than expected deposit

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

growth, and higher than expected costs for case resolutions.

Funding for the bailout comes from four main sources: the sale of FICO and REFCO bonds, the thrift industry, the sale of assets from failed thrifts, and U.S. taxpayers.

Bond sales:	Billions
FICO bonds	$7
REFCO bonds	50
Thrift industry contributions:	
Earnings from Federal Home Loan Banks	5
Premiums paid for S & Ls	60
Liquidation proceeds:	
Sale of failed thrifts' assets by RTC	30
Treasury appropriations:	
U.S. taxpayers' funds	183
Total revenues over 30 years	335

Under the Administration plan, if any of the economic assumptions are off, taxpayers pick up the shortfall. Thus if interest rates are higher than expected, if a recession occurs, if deposit growth slows, or if the cost of case resolutions increases, it is America's taxpayers who pick-up the additional tab. Thus, it is imperative that all groups who are responsible for the problem be made to pay.

FAILURES BY STATE GOVERNMENTS

The Administrative plan, which, by and large, has been adopted by the Committee, fails to recognize that a relatively small number of state legislatures and state regulators are responsible for a large portion of the problems of the thrift industry. Key state legislatures and regulators:

****210** Gave state-chartered thrifts risky new powers they could not properly manage.

Failed to adequately regulate the risky activities they granted.

Granted charters to groups with little or no experience in operating thrifts.

Reduced the size of their examination staffs and the frequency of thrift supervision.

The evidence is clear that it is primarily state-chartered institutions, and not federally-chartered institutions, which are respnsible for the bulk of the thrift industry's losses.

In 1987 the FSLIC resolved the problems of 47 thrift institutions at an estimated cost to the insurance fund of $3.7 billion. Stated-chartered institutions were responsible for $2.4 billion, or two-thirds of the total.

In 1988 the FSLIC resolved the problems of 205 thrift institutions at an estimated cost to the insurance fund of $3.7 billion. State-chartered institutions were responsible for $23.3 billion, or three-quarters of the total.

*310 STATE–BY–STATE THRIFT RESOLUTION COSTS

Chart 1 below shows the present value of FSLIC's case resolutions, on a state-by-state basis, in 1987 and 1988 for both federal and state-chartered thrifts. It should be noted that the thrifts closed in 1987 and 1988 were "the worst of the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

worst," the ones FSLIC was forced to shut-down because their problems were so great.

CHART 1.—PRESENT VALUE RESOLUTION COSTS

[In millions of dollars]

	1987		1988		Total 1987 and 1988	
	Federal charter	State charter	Federalcharter	State charter	Federal charter	State charter
Alabama	1	0	13	0	14	0
Alaska	0	2	0	0	0	2
Arizona	0	0	24	4	24	4
Arkansas	91	1	0	0	91	1
California	218	498	304	5,137	522	5,635
Colorado	0	0	191	324	191	324
Connecticut	0	0	0	0	0	0
Delaware	0	0	0	0	0	0
District of Columbia	0	0	0	0	0	0
Florida	0	0	1,149	167	1,149	167
Georgia	0	0	5	0	5	0
Hawaii	0	0	0	0	0	0
Idaho	121	0	2	0	123	0
Illinois	169	4	1,123	257	1,292	261
Indiana	0	0	103	50	103	50
Iowa	0	102	238	88	238	190
Kansas	20	0	0	20	20	20
Kentucky	0	0	84	0	84	0
Louisiana	472	67	177	0	649	67
Maine	0	0	0	0	0	0
Maryland	69	0	0	0	68	0
Massachusetts	0	0	0	0	0	0
Michigan	0	0	122	53	122	53
Minnesota	0	0	206	0	206	0
Mississippi	0	14	0	0	0	14
Missouri	2	97	0	0	2	97
Montana	0	0	11	0	11	0
Nebraska	0	0	0	0	0	0
Nevada	0	5	0	0	0	5
New Hampshire	0	0	0	0	0	0

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

New Jersey	0	55	221	12	221	67
New Mexico	0	0	84	0	84	0
New York	0	0	0	0	0	0
North Carolina	0	0	0	34	0	34
North Dakota	0	0	0	0	0	0
Ohio	22	0	377	101	399	101
Oklahoma	41	0	697	46	738	46
Oregon	0	27	205	157	205	184
Pennsylvania	0	0	0	0	0	0
Rhode Island	0	0	0	0	0	0
South Carolina	0	0	0	0	0	0
South Dakota	0	0	8	0	8	0
Tennessee	0	0	34	0	34	0
Texas	0	1,504	1,931	16,686	1,931	18,190
Utah	0	46	0	0	0	46
Vermont	0	0	0	0	0	0
Virginia	35	0	14	122	49	122
Washington	0	22	69	24	69	46
West Virginia	0	0	82	0	82	0
Wisconsin	0	0	0	0	0	0
Wyoming	0	0	147	0	147	0
U.S. total	1,261	2,442	7,619	23,282	8,880	25,724

Source: Federal Home Loan Bank Board.

**211 *311 Nationwide, state-chartered thrifts represent three-quarters of all FSLIC case resolution costs in 1987 and 1988.

The FDIC is currently in the process of taking over an additional 232 insolvent thrift institutions with $77.4 billion in assets. While the FDIC does not yet know how large the losses are at these institutions, it does report that once again well over half the assets are held at state-chartered thrifts.

COSTS AND BENEFITS BY STATE

Dr. Edward W. Hill, Assistant Professor of Urban Studies at Cleveland State University has estimated the per capita costs and benefits of the thrift bailout for each state. Chart 2 below shows the difference (on a per capita basis) between what a state's residents receive from the bailout and what they pay in additional federal income taxes. A positive figure means they receive more than they pay. A negative figure means they pay more than they receive. The figures range from a net benefit of $2,728 per resident of New Mexico, to a net cost of $479 per resident of Connecticut.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

CHART 2.—WHAT STATES GAIN (+), OR LOSE (-) PER CAPITA ON FLOW OF FEDERAL TAX DOLLARS TO RESOLVE TROUBLED THRIFTS

Alabama	-47	Montana	-215
Alaska	+743	Nebraska	+465
Arizona	+755	Nevada	-403
Arkansas	+2,357	New Hampshire	-375
California	-283	New Jersey	-413
Colorado	+35	New Mexico	+2,728
Connecticut	-479	New York	-360
Delaware	-331	North Carolina	-234
District of Columbia	-471	North Dakota	-231
Florida	+105	Ohio	-292
Georgia	-264	Oklahoma	-242
Hawaii	-332	Oregon	-269
Idaho	-194	Pennsylvania	-273
Illinois	-232	Rhode Island	-324
Indiana	-280	South Carolina	-197
Iowa	+183	South Dakota	-204
Kansas	+190	Tennessee	-209
Kentucky	-224	Texas	+1,856
Louisiana	+621	Utah	+303
Maine	-225	Vermont	-247
Maryland	-109	Virginia	-344
Massachusetts	-399	Washington	-303
Michigan	-346	West Virginia	-205
Minnesota	-346	Wisconsin	-229
Mississippi	+159	Wyoming	-300
Missouri	+39		

*312 SHARING THE BURDEN

Under the Administration plan, the thrift industry—including many innocent and healthy thrifts—will pay tens of billions to clean up this mess.

Under the Administration plan, American taxpayers—who did nothing to cause the problem—will pay hundreds of billions to cleanup this mess.

Under the Administration plan, the banking industry—which did not create this problem—will pay tens of billions to strengthen its insurance fund.

Yet, under the Administration plan, the states—particularly those which allowed state-chartered thrifts to run wild—do

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

not have to contribute a penny.

Two states alone, Texas and California, are responsible for more than three-quarters of all thrift resolution costs in 1987 and 1988, and a majority of future projected costs as well. Yet neither is asked to contribute a penny even though more than 90% of the problem in each state is due to state-chartered thrifts. Our Committee's hearings have documented a pervasive pattern of indifference, incompetence and irresponsibility on the part of state officials in the states with the bulk of our problems. They gave away powers and charters, and reduced examinations, knowing that if anything went wrong Uncle Sam would pick up the tab.

**212 In short, not only was there no market discipline on the states, there was actually an incentive to be irresponsible. Like most of our failed thrifts, the states were gambling with other people's money—the U.S. taxpayer's money.

THE MATCHING FUNDS CONCEPT

The vast majority of federal grant programs enacted in recent years have required some type of state or local matching contribution.

Similarly, every past bailout the federal government has participated in has required contributions or sacrifices by state and local governments or other interested parties.

When the federal government assists state unemployment insurance funds which have run out of money, it does not provide direct grants. Instead, it provides loans which must be repaid with interest through expensive unemployment insurance surcharges on employee wages in the affected states.

When the federal government bailed-out Lockheed in 1971, Lockheed only received loan guarantees and not loans or grants. When the federal government bailed-out New York City in 1975, New York only received loans and not grants. When the federal government bailed-out Chrysler in 1980, Chrysler only received loan guarantees and not loans or grants. In each of these cases the loans or loan guarantees were repaid with interest, enabling the federal government to end up ahead on the deal. This is because we required significant sacrifices by state and local governments or other interested parties.

*313 Yet this bill does not make loans or loan guarantees. It makes direct cash payments and does not require contributions from anyone other than the banking and thrift industries, and the American taxpayer.

We believe it is patently unfair and fiscally irresponsible to proceed in this way.

Nevertheless, we are not proposing that state governments pay for the cost of federally-chartered thrift institutions which have failed.

We are not even suggesting that state governments pay for the full cost of state-chartered thrift institutions which have failed.

All we ask under the matching funds proposal is that state governments make a partial, and modest, 20% matching contribution to the cost of their own state-chartered thrift institutions which have failed.

We are willing to forgive this contribution if a state's taxpayers are already overtaxed and do not have a capacity to pay more (as measured by data from the Advisory Committee on Intergovernmental Relations). We are also willing to spread large payments over a four year period if that is necessary to ease the burden.

We are even willing to give states a constructive alternative. We will give them a credit towards their 20% matching payment for purchases from the newly established Resolution Trust Corporation (RTC) of distressed thrift assets in their state. This way, instead of making payments to the federal government, states can invest in their own future by buying local real estate. This will help their local economies by reducing the pressure for a "fire sale" of distressed real estate assets.

**213 Under our proposal most states would pay nothing either because their state-chartered institutions have been healthy, or because they lacked the ability to pay. A handful of states (see Chart 3 below) would pay relatively small amounts, but these payments would be offset by the reduction in the cost of the overall plan to federal taxpayers gener-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ally. Only two states, Texas and California, where most of the problems have been, would make any substantial payments. Even these states could reduce their direct payments to zero by purchasing distressed assets from the RTC.

CHART 3.—State contributions if matching funds concept had been in effect in 1988

[In millions of dollars]

State:	Amount
California	1,027
Colorado	65
Florida	33
New Jersey	2
Oklahoma	9
Texas	3,337
Virginia	24
Total	4,497

*314 STATE PARTICIPATION IS VOLUNTARY

Participation in our matching funds proposal is strictly voluntary. If a state does not wish to participate it does not have to. After appropriate notice is given to protect depositors, states may choose to set up their own deposit insurance system for state-chartered institutions. The federal government would continue to insure federally-chartered institutions, and state-chartered institutions which meet federal standards could covert from state to federal charters.

MATCHING FUNDS REQUIREMENTS ARE NOT A TAX AND THEY ARE CLEARLY CONSTITUTIONAL

A thorough analysis of the matching funds proposal by the American Law Division of the Library of Congress concludes that it is fully Constitutional and is not a tax. Established case law documents that it is permissible for the federal government to set guidelines and conditions for participation in federal programs such as deposit insurance. The Library's analysis follows:

CONGRESSIONAL RESEARCH SERVICE,
THE LIBRARY OF CONGRESS,
Washington, DC, April 10, 1989.

To: Hon. Marcy Kaptur, Attention: Doug Glovier.
From: American Law Division.
Subject: Analysis of amendment to H.R. 1278, 101st Cong., 1st Sess.

This responds to your request for an analysis of an amendment to H.R. 1278 that was offered by Mr. Kanjorski and Ms. Kaptur.

Section 209 would amend the Federal Deposit Insurance Act, 12 U.S.C. § 1818(a) to require the Federal Deposit Insurance Corporation (FDIC) to estimate the costs of revolving cases with respect to state chartered savings associations insured by the Federal Savings and Loan Insurance Corporation as of the date of enactment of H.R. 1278, state chartered savings associations that are members of the Savings Association Insurance Fund, and state banks insured before encatment of H.R. 1278 or state banks that are members of the Bank Insurance Fund.

It would further require, as a condition of insuring those institutions, that states chartering such institutions make an annual matching payment equal to a percentage of the cost of case resolution as determined by the FDIC. A waiver

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

would be allowed for any state for any year from which the state's tax effort, as measured by the Advisory Commission on Intergovernmental Relations, is at least 95% of its tax capacity.

**214 Matching funds are to be due six months after FDIC issues its estimate; if a state does not tender its funds within six months of the due date, the FDIC is to terminate deposit insurance for institutions chartered by that state. Thereupon FDIC is to require the institutions to notify depositors of the termination of insurance.

Each state is to be allowed a credit toward the matching fund for qualified distressed property acquisitions during the preceding year, a category that is to include any acquisition by the state of real property from the Resolution Trust Corporation for which the state pays at least 75% of the book value and which represents a *315 cross section of all property held or managed by the Resolution Trust Corporation in the state.

If any state's matching fund requirement reaches $1 billion for any year, the state may pay such over a 4–year period under an agreement with the Secretary of the Treasury.

In estimating the first year of matching funds, the FDIC is to include all assistance provided by the Federal Savings and Loan Insurance Corporation beginning on January 1, 1988.

The Secretary of the Treasury is given authority to make annual adjustments in terms of actual as opposed to estimated costs for any annual period.

If insurance is terminated for any state's insured institutions, that termination may be revoked only if the state has repaid all matching funds plus interest as prescribed by the Secretary of the Treasury.

After termination, insured deposits within the state (less any withdrawal from such deposits) shall continue to be insured and the institutions holding them continue to pay assessments for a two-year period.

The matching payment would appear to be neither a tax nor a fee. It places a condition on the grant or continuance of federal deposit insurance on deposits held in state-chartered institutions: the states chartering these institutions will have to pay matching funds or buy property that the federal government has obtained from failing or failed institutions within the state in order to maintain federal deposit insurance coverage of state-chartered institutions. Such conditional grants of federal funding have been upheld by the Supreme Court since Steward Machine Co. v. Davis, 301 U.S. 548 (1937), which upheld a tax on employers and a credit paid to states to provide unemployment benefits as within the authority of Congress to spend for the public welfare. In Oklahoma v. Civil Service Commission, 330 U.S. 127 (1947), the Court upheld the authority of Congress to require states accepting federal highway grants to restrict the activities of state highway employees with respect to partisan politics, saying

> [w]hile the United States is not concerned with, and has on power to regulate local political activities as such of State officials, it does have power to fix the terms upon which its money allotments to State shall be disbursed. * * * The end sought by Congress through the Hatch Act is better public service by requiring those who administer funds for national needs to abstain from active political partisanship. So even though the action taken by Congress does have effect upon certain activities within the State, it has never been thought that such effect made the federal act invalid.—330 U.S. 127, 143.

**215 While it is true the proposal does not involve a direct grant to the states, it does involve a condition, continuance of federal deposit insurance, which facilitates the chartering by states of depository institutions. Without access to federal insurance state wishing to continue to charter such institutions presumably would have to guarantee deposits against institutional failure or permit the institutions to attempt to survive with private or no insurance. In the*316 absence of a state's compliance with the requirements of this amendment, the institutions that it has chartered could, themselves, elect to attempt to qualify for federal insurance. The ultimate objects of the legislation could, thus, be viewed as requiring states permitting conditions leading to of state-chartered institutions to share in the cost of resolving those failures as well as in fostering uniformity of regulation of institutions insured by the federal government.

Retroactivity is another element of this legislation that you have questioned. It would require the states to shoulder some percentage of FSLIC resolutions since January 1, 1988. This provision is not on its face unconstitutional. The Supreme Court has stated the test of retroactive legislation in terms of rationally, i.e., whether "the retroactive application ...

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

is justified by a rational legislative purpose." Pension Benefit Guaranty Corp. v. R.A. Gray Co., 467 U.S. 730 (1984) (upholding retroactivity of pension plan termination provisions to the period that Congress was considering the subject legislation). Provided Congress indicates a rational basis for this retroactivity: spreading the costs of resolving a situation that states may have fostered or contributed to by lack of strong supervision over state-chartered thrifts or arming state-chartered thrifts with powers that induced reckless behavior may be sufficient to require states to share costs retroactively. The Supreme Court has upheld retroactive legislation on the basis of its being a rational means of spreading costs. In Usery v. Turner Elkhorn Mining Co, 428 U.S. 1 1976), the Court upheld a federal statute that required coal mine operators to compensate former employees developing black lung disease including those whose employment had ceased before passage of the act. In reaching its decision, the Court made it clear that in enacting retroactive legislation, Congress must meet certain due process standards, including notice. Since the industry had been on notice of the possible link between black lung disease and mineworking, there was deemed to be adequate notice. The black lung legislation's retroactivity, moreover, was rationally based: "the imposition of liability for the effects of disabilities bred in the past is justified as a rational measure to spread the costs of the employees' disabilities to those who have profited from the fruits of their labor—the operators and the coal consumers." 427 U.S. 1, 18.

**216 We hope this information is helpful to you and that you will call upon our office should you need further assistance.

M. MAUREEN MURPHY,
Legislative Attorney.

MATCHING FUNDS WILL PROMOTE EQUITY, REDUCE THE COST TO TAXPAYERS, AND INSTILL GREATER RESPONSIBILITY AT THE STATE LEVEL.

Our modest matching funds requirement will allow us to correct a serious flaw in this bill. It is designed to encourage states to take greater responsibility for their actions, and to give real meaning to the concept of a "dual" banking system. Since expanded state powers and lax state regulation hold a significant share of the*317 blame for our current predicament, it is only appropriate that they pick up at least a modest part of the cost of the bailout.

Under our proposal, most states would pay nothing. Those that do pay would only pay a small portion of the total cost of the bailout. These new funds would, however, reduce the ultimate cost to federeal taxpayers. This is particularly important if the GAO is correct that the Administration plan is based on optimistic assumptions and consequently additional revenues are necessary. Under the Administration plan and the Committee bill, federal taxpayers pick-up the full cost of any shortfall. The matching funds proposal would provide an alternative source of funds, and a small measure of relief for already overburned federal taxpayers.

PAUL E. KANJORSKI.
JOHN. H. LAFALCE.
LIZ PATTERSON.
MARCY KAPTUR.
TOBY ROTH.
PETER HOAGLAND.

MINORITY VIEWS ON FUNDING

We strongly endorse the Committee's decision to adopt the off-budget funding mechanism proposed by the President. Those who argue that on-budget financing would save billions of dollars are simply wrong. OMB Director Richard Darman testified that the savings on a net present value basis of on-budget financing amount to only $1.2 billion. We say "only $1.2 billion" because we believe that this is a small price to pay for maintaining the sanctity of the Gramm–Rudman–Hollings process under which the Federal budget deficit has been cut from $220 billion in 1986 to ap-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

proximately $100 billion in Fiscal Year 1990. Gramm–Rudman–Hollings is the last bulwark of fiscal discipline. To make a mockery of it, as Treasury Secretary Brady has said, would border on the irresponsible. Further, as several experts testified, an on-budget solution could have the unintended effect of raising Treasury's borrowing costs across the board, thus entirely offsetting any anticipated savings. We urge the full House to reject any attempt to change the funding mechanism of this plan.

CHALMERS P. WYLIE.
NORMAN D. SHUMWAY.
STAN PARRIS.
BILL MCCOLLUM.
JOHN HILER.
TOM RIDGE.
STEVE BARTLETT.
AL MCCANDLESS.
JIM SAXTON.
PATRICIA SAIKI.
RICHARD H. BAKER.
BILL PAXON.

*318 ADDITIONAL MINORITY VIEWS ON CAPITAL STANDARDS

The crisis in our Nation's savings and loan industry is the most important financial institutions issue facing the Congress since the collapse of the banking system in the early 1930's. President Bush recognized the gravity of the situation by announcing a comprehensive plan to both fund and fix the problem on February 6—just 18 days after his inauguration—and by calling for speedy Congressional action.

**217 The President's plan included two essential elements: first, an off-budget funding mechanism; and second, necessary structural and regulatory reforms to ensure that the problem does not recur. We are pleased that the Committee acted responsibly by accepting both elements of the President's plan.

Central to the structural and regulatory reforms are tough new capital standards. As Treasury Secretary Brady said:

> As the Committee begins its deliberations, I want to highlight a mutual concern of ours: the need to bolster real capital in the savings and loan industry to safe and prudent levels. More than any other factor, the massive losses in the thrift industry—which this legislation funds—were due to growth without sufficient private capital at risk. I know we agree that prudent capital levels are the taxpayers' best defense.

Secretary Brady's views were echoed by Comptroller General Bowsher who said:

> * * * inadequate capital creates incentives for institutions to engage in unsafe and unsound practices. These practices can, and often do, result in losses to the deposit insurance funds. The taxpayer is now facing a problem of unprecedented proportions due, in no small measure, to our prior lack of insistence upon adequate tangible capital requirements. Adequate tangible capital provides a buffer to protect the insurance funds and, therefore, the taxpayer from loss and instills discipline in an institution's management since it is the owners' own capital which is at risk.

We strongly support the capital standards adopted by the Committee and feel that it is to Chairman Gonzalez's credit that he exercised the strong leadership necessary to ensure the adoption of responsible capital standards. Under the provisions approved by the Committee, savings and loans will be required to meet a 3 percent tangible capital requirement by December 31, 1994. During a four-year phase-in period some credit will be provided for "good-will." The capital standards represent a compromise. Some Members favored full credit for goodwill and other intangibles, while others favored even tougher tangible capital standards. The standards*319 adopted are fair and equitable and meet the Administration's goal of bringing savings and loan capital standards up to those of national banks within a reasonable period of time.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The new capital standards approved by the Committee are realistic and attainable by the overwhelming majority of the thrift industry. If the 3 percent requirement were applied today, 1,996 institutions with $598 billion in assets would meet or exceed the capital requirement. Currently, 453 institutions have tangible capital of between 0 and 3 percent. These institutions, which have assets of $463 billion and $7.5 billion in tangible capital, would have to raise $6.4 billion to meet the 3 percent tangible capital to total assets requirement. Of these institutions 207, with $145 billion in assets and $3.6 billion in tangible capital, have between 2 and 3 percent tangible capital and should easily be able to raise the $700 million needed to meet the 3 percent requirement. Some of the remaining 246 institutions, with $318 billion in assets and $3.9 billion in tangible capital, might have to merge with stronger institutions to raise the $5.7 billion necessary to meet the 3 percent requirement.

**218 We would point out that under the compromise, December 31, 1994 is not a "drop dead" date for those in noncompliance. The legislation provides an explicit procedure for an institution to seek an exemption from the sanctions for noncompliance. If an institution is well managed and its failure to meet the capital standards is not the result of fraud or other egregious factors, an exemption will be granted. Under such an exemption, limited growth would be permitted, but only in low risk assets and only if that growth is fully capitalized. In short, regulatory flexibility is provided to ensure that those institutions which are gaining ground will not be shut down.

CHALMERS P. WYLIE.
MARGE ROUKEMA.
TOBY ROTH.
JIM SAXTON.
CLIFF STEARNS.
PAUL E. GILLMOR.

*320 MINORITY VIEWS ON HOUSING PROVISIONS

This legislation will provide for the liquidation or merger of some 500 insolvent savings and loans and has an obvious impact on housing. The Resolution Trust Corporation (RTC) will be charged with the disposition of several hundred billion dollars of real estate assets, including an unknown number of residential properties. There is a broad bipartisan consensus that the Congress must not permit critical emergency legislation to get slow tracked by the inclusion of extraneous matters that should be left to another time. Experts are in general agreement that each day we fail to enact necessary legislation adds $20 to $30 million to the ultimate cost.

On a bipartisan basis, the bill reported by the Committee contains several provisions legitimately impacting on housing policy issues. Examples include a strengthened qualified thrift lender test to ensure that thrifts remain true to their mandate to promote homeownership and a directive to the RTC to give due consideration to low- and moderate-income housing needs in its real estate disposition program.

The provision adopted by the full Committee mandating a so-called "Affordable Housing Program" at each of the twelve Federal Home Loan Banks, however, would create an expansive new housing program and is out-of-place in this emergency legislation. We note that no similar provisions are included in the bill passed by the Senate on April 19 and we are concerned that the Majority's decision to incorporate these provisions could lead to protracted negotiations in conference and further delays in getting legislation to the President's desk.

Under the amendment, the newly created Federal Housing Finance Board must establish minimum standards of community investment/service for membership to the Federal Home Loan Banks, based on performance under the Community Reinvestment Act of 1977, and a commitment to lending in low- and moderate-income neighborhoods. In addition, each Federal Home Loan Bank must have an affordable housing program for the sole purpose of "subsidizing the interest rate on advances to members engaged in lending for long-term affordable low-and moderate-income housing at subsidized interest rates." Although few details are provided on exactly how this program is intended to work, the pro-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

gram seems to be primarily directed to multifamily projects with no mention of homeownership opportunities.

**219 The new housing program would be funded by contributions from the Federal Home Loan Banks. From 1990 through 1993 the Banks would be required to contribute 5 percent of their net income, but no less than $75 million per year to fund the program. The minimum required contribution would rise to 6 percent of net income, but no less than $90 million in 1994, and to 10 percent of net income, but no less than $150 million in 1995 and after. These *321 funds come from the net income of the FHLBanks and will even further reduce the ability of the Banks to pay dividends to the thrift industry.

The amendment changes the additional earnings contributions from the FHLBanks to the Resolution Funding Corporation (REF–CORP) from $300 million per year to the lesser of $300 million or 20% of annual net income. Under this provision, if the net income of the FHLBanks falls below the 1988 level of $1.5 billion, FHLBank payments for REFCORP capital stock or interest on REFCORP obligations will be reduced below the budgeted $300 million yearly estimate. Of course, such a shortfall would have to be made up by Treasury and would increase taxpayer contributions and the deficit by the amount of the shortfall.

Although we understand and share the concerns of the Majority over low- and moderate-income housing needs, we believe that the taxpayers have already been asked to shoulder enough of the burden and we categorically reject the Majority's contention that adding an additional $75 to $150 million per year to that burden is de minimis. We are concerned that the Committee, particularly in this atmosphere of budget restraint and the very critical need to resolve the thrift crisis, has seized this opportunity to avoid the discipline of the budget and appropriations process by diverting funds intended to recapitalize the insurance fund and protect depositors in our Nation's thrift industry to the creation of a new subsidized housing program.

We further believe that this provision jeopardizes the entire financing mechanism, which the Administration carefully crafted to ensure that the principal on the REFCORP bonds is fully covered by private capital. If taxpayer funds are used to pay any of the principal on the bonds, this could cause the financing arrangement to be treated as entirely on budget. We are also concerned about the potential impact of this program on the viability of the Federal Home Loan Banks. The program imposes further additional costs ($540 million through 1995) as well as a new, primarily multifamily rental financing program on a system structured to encourage homeownership.

Republicans and Democrats alike share the common goal that certain RTC real estate assets be used where possible as a housing resource for low- to moderate-income persons. But we oppose the amendment under which the Resolution Trust Corporation is required to give a right of first refusal on residential properties held by the RTC to public agencies, nonprofits, and low-income families and to subsidize the sales price below current market value and extend subsidized credit for such property. Establishing a mandatory, cumbersome, and restrictive procedure could have the unintended effect of tying up property disposition in litigation, thus imposing further costly delays on the resolution of insolvent thrift cases.

**220 The primary mission of the RTC is to resolve failed thrift cases and dispose of assets at minimum cost to the taxpayer. Providing explicit subsidies through further reductions in property value (or outright give-away) and offering subsidized financing for selected acquirers increases costs unnecessarily. Moreover, long-term lending is incompatible with the intended short-term life of the RTC. *322 Finally, the provision includes an authorization of 15,000 Section 8 and FmHA units, if backed up by an appropriation, which would probably result in smaller future assistance allocations in regions where the need may be greater. If enacted, this would probably cut into HUD's annual appropriation for new assistance.

Since we share the common goal of utilizing some portion of the unknown inventory of eligible residential property to maximize low- and moderate-income housing opportunities, we would hope that our differences can be resolved.

CHALMERS P. WYLIE.
NORMAN D. SHUMWAY.
STAN PARRIS.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

BILL MCCOLLUM.
MARGE ROUKEMA.
DAVID DREIER.
JOHN HILER.
STEVE BARTLETT.
TOBY ROTH.
AL MCCANDLESS.
JIM SAXTON.
PATRICIA SAIKI.
JIM BUNNING.
RICHARD H. BAKER.
CLIFF STEARNS.
PAUL E. GILLMOR.
BILL PAXON.

*323 ADDITIONAL VIEW OF HON. NORMAN D. SHUMWAY

The proposed transfer of Federal regulatory authority over state-chartered savings associations from the Federal Home Loan Bank Board to the Federal Deposit Insurance Corporation is an ill-advised measure that will lead to less effective regulation and supervision of state-chartered associations. Unfortunately, the urgency of the Congressional action on the savings and loan crisis did not allow time to fully develop and consider this provision during the Committee's deliberations. The Senate's retention of the original language will call for this discrepancy to be considered in conference.

The present version of the bill leaves unchanged the Federal Home Loan Bank System regulation of Federally-chartered thrifts. But, contrary to the recommendation of the Administration in the bill as originally drafted, the present bill would make the FDIC the primary Federal regulator of state-chartered thrifts. This change recreates the problematic combination of the roles of regulator and deposit insurer that many consider to be one of the causes of the current thrift crisis.

It is unrealistic to believe that the proposed shift of Federal regulatory authority over state thrifts would improve regulatory oversight of thrifts. It should be remembered that the FDIC is not seeking this additional extension of its responsibilities already augmented by this bill and the consequently heightened strain on its resources.

Although the FDIC will be the new insurer of these thrifts, it does not mean that it should take on an additional administrative role with them.

Finally, the argument that the Administration's bill establishes a burdensome system of regulation by three agencies (the FDIC, the FHLBB, and the state regulators) fails to note the complementary differences between the state-institution reponsibilities of the three. In fact, the same amount of supervision is intended under each plan. The issue is whether the duties of insurer and Federal administrator should be vested in one body.

**221 NORMAN D. SHUMWAY.

*324 ADDITIONAL VIEWS OF HON. MARGE ROUKEMA ON RISK–BASED PREMIUMS

During the Committee's extensive hearings on the S & L insurance crisis, it became apparent that risky investments were a major contributing factor to the demise of the insurance fund. I believe that while risky investments can never be totally prevented, it should be clear that those institutions who engage in them, should compensate the insurance fund for any potential problem. The Roukema/LaFalce amendment, which was adopted in Subcommittee, by a vote of 28–19, would give authority and discretion to the FDIC to create and implement a system of risk-based premiums.

Under the Roukema/LaFalce amendment, a risk-based insurance premium structure may be implemented after Decem-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ber 31, 1991 for Bank Insurance Fund (BIF) members, and after December 31, 1994 for Savings Association Insurance Fund (SAIF) members. The FDIC may establish assessment categories for BIF and SAIF members after an initial study period and may establish these categories independent of each other, using independent criteria but clearly related to the risk presented to the BIF or SAIF.

The current system of insurance premiums, flat-rate premiums—levying the same fees on safe and risky institutions for equivalent amounts of deposits insurance—provides incentives for excessive risk-taking and inequitably distributes the burden of insurance losses among institutions. "Risk-based" premiums are a system of rates which are assigned to various types of business activity determined to be more sensitive to market discipline, regulation and supervision. Banks and thrifts engaged in these types of investments, would be required to pay additional insurance premiums to cover potential problems which could place the insurance fund in jeopardy. Conversely, banks and thrifts engaged in low-risk activities may be able to lower their insurance premiums.

While there is agreement that flat-rate premiums may encourage risk-taking there is less agreement whether a more explicit risk-related pricing scheme can be developed. Nevertheless, private sector insurance companies for life, auto, health, homeowners and fire insurance all manage on the risk-based concept. There is no reason why this concept cannot apply to deposit insurance. In fact, the FDIC in it's study, "Deposit Insurance for the Nineties", supports the establishment of risk-based premiums as a critical element in the future of the banking system. The FDIC found that experiences during this past decade, particularly bank failures and the S & L crisis, have given rise to major concerns about the continuing viability of the system. In particular, the concern focused on the current system's ability to sufficiently control excessive risk-taking.

*325 A system of risk-related premiums would be a tangible consequence which banks and thirfts can observe directly in order to determine the price of moving to riskier positions.

**222 A system of risk-related premiums would also provide banks, analysts, and the public with information more suitable for making interbank comparisons of risk. It would be relatively easy for analysts to construct a list of the ten, twenty or fifty "riskiest" thrifts or banks. This factor, in the long run, may increase the deterrent effect of risk-related activity and protect insured deposits with threat risk to the insurance fund or the taxpayer.

From a regulatory perspective, adopting risk-related premiums would force regulators to be more explicit in defining desirable and undesirable behavior for banks and thrifts. This increased visibility would provide greater incentives for regulators to reassess existing industry risks and to detect emerging risks.

The Roukema/LaFalce amendment would permit the FDIC to establish risk based premiums based on categories of institutions that present particular types of risks to the insurance fund. The risks may be greater or lesser than those presented by the "typical" institution, and this provision gives the FDIC the ability to reflect that risk profile in the assessment rates.

With respect to the relationship between risk-based premiums and risk-based capital, which was also adopted by the Committee, the two approaches are not mutually exclusive. There is no reason why banks in a high risk profile should not both maintain higher capital and pay higher insurance premiums. The two approaches complement each other and lead to a safer and sounder banking system.

Finally, the ability to impose risked based premiums does not arise until after the fixed premium schedule set forth in this legislation expires. The provision further provides that if risk based premiums are established, any rebates should be made in the same manner as detailed in the legislation.

MARGE ROUKEMA.

*326 ADDITIONAL VIEWS OF REPRESENTATIVES HILER, RIDGE, BARTLETT, DREIER, McCANDLESS, SAIKI, BAKER, AND PAXON

ADDITIONAL VIEWS

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Facing the worst deposit insurance crisis in the last fifty years, the Bush Administration has come forward with a bold plan for which the Administration should be applauded. We are particularly pleased that nearly all of the fundamental precepts of the Bush plan are embodied in H.R. 1278 as reported by the Committee, specifically: (1) extension of much-needed regulatory authority to the Federal Deposit Insurance Corporation; (2) improvements to supervision and enforcement of banks and thrifts; and (3) new requirements for thrifts to maintain an adequate capital cushion by the application of national bank capital standards. We commend Committee Chairman Gonzalez and Subcommittee Chairman Annunzio for their work in expeditiously moving this legislation. We believe, however, that further improvements could be made to the legislation.

CAPITAL

We embrace the prevailing Committee view that risk-based capital standards, as proposed by the Office of the Comptroller of the Currency for national banks, are essential to preventing another deposit insurance crisis. There should be no doubt that the Administration, the Committee and the regulators share the same goal in terms of eliminating intangibles or "phantom" capital from the core capital base that provides an indispensable economic cushion. However, it is our view, that some inequities have resulted in the manner in which this goal is reached.

**223 Specifically, we refer to the impact of the current plan on those healthy institutions that were urged by the Federal Home Loan Bank Board (FHLBB) in the early 1980s to acquire unhealthy thrifts. These institutions did not receive cash or FSLIC notes from the government, but rather assistance in the form of "supervisory goodwill," which could be counted on the books as capital. These transactions were accompanied by a plan for the acquiror to gradually phase-out or "write down" the goodwill and to replace it with other forms of capital in order to return health to the consolidated institution. The length of the phase-out varies anywhere from 20 to 40 years. The bill, however, would interrupt the phase-out in mid-stream, leaving the institutions with only a four-year period in which to attract other forms of capital.

As a result, many of these institutions will be labeled unsafe and unsound, be placed under a supervisory arrangement and have their growth controlled. Once growth is restricted, it will be extremely*327 difficult for institutions saddled with supervisory goodwill to raise capital in the public markets especially when they will have to comply with the bill's other provisions, such as: increased deposit insurance premiums and reductions in dividends from the twelve district banks of the Federal Home Loan Bank system.

For the institutions with substantial supervisory goodwill, the bill radically changes the terms of previously negotiated transactions, leaving no transition for worthy institutions. The bill provides no flexibility for the regulator to consider progress by these institutions in attracting capital, the rapid write-down of intangible assets, including goodwill, and other improvements in the financial position and management of the institution. While adequate capital is fundamental to the health of the deposit insurance system, other measures of an institution's viability should also be considered.

We believe the bill could be improved by according the regulators sufficient flexibility with regard to viable institutions burdened with goodwill without undermining critical capital standards. The Office of the Comptroller of the Currency has this flexibility for national banks and we see the extension of the same principle to thrifts with goodwill as appropriate. In the same manner as applied to national banks, we believe that the Chairman of the Federal Home Loan Bank should be provided with authority to allow, on a case-by-case basis, institutions that acquired goodwill as a result of supervisory transactions to not deduct goodwill from existing capital. No general exception would be provided and only truly worthy cases would be considered. Additionally, the burden of proof would be on the thrift, not the regulator. While we understand congressional concern to stop unwise forbearances, we believe that legislating absolute inflexibility for federal regulators is similarly unwise.

RESOLUTION TRUST CORPORATION

**224 The President's proposal calls for the creation of a Resolution Trust Corporation (RTC) to: (1) resolve current

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

and expected insolvent savings and loan problems; and (2) dispose of assets, quickly and prudently. We feel that H.R. 1278 (as reported out of the Committee) generally meets these objectives.

PROPERTY FOR LOW–INCOME HOUSING

We are concerned, however, about language requiring the RTC to give the right of first refusal to parties interested in acquiring property for use by low-and moderate-income households. In particular, we are concerned about the process under which the RTC would have to make the property available. For example, designating a specific percentage of residential units which must be sold to lower income families may be inappropriate since it is unclear how large of an inventory, and what kind the RTC will assume once it goes into operation.

We are strongly opposed to a related provision: requiring each Federal Home Loan Bank to create an affordable housing fund to subsidize interest rates for loans to low- and moderate-income households. The provision is, in effect, a federal tax on a set of financial institutions operating primarily in the private sector. *328 H.R. 1278 already cuts the dividend stream of each of the Federal Home Loan Banks, since they will be required to make an annual contribution to help cover FSLIC obligations. Three of the twelve Federal Home Loan Banks have already indicated that they will not be able to meet the annual contribution requirement.

ASSET DISPOSITION

In our view, the addition of an amendment offered by Representatives Wylie and Annunzio provides adequate guidance to the RTC to dispose of property on an orderly basis. The amendment directs the RTC to take into consideration local economies and markets. The RTC is also directed to use private sector resources to determine how best to dispose of the property.

Given the significant volume of acquired property to become part of RTC inventory and the fact that in some cases, holding on to the property will be extremely costly for the Federal government, we agree that the RTC should transfer some residential property for use by low-income communities. We believe that the Wylie/Annunzio amendment, coupled with Representative Bartlett's amendment authorizing the urban homesteading program, gives sufficient direction to the RTC to work with non-profit organizations and state housing finance agencies to facilitate such a transfer.

Further requirements on how the RTC should dispose of property will only hamper the Corporation's efforts. It is not the place of Congress to decide how best to dispose of assets—that is something best left to the real estate experts in the marketplace. We concur with Treasury Secretary Brady's comments that the RTC needs "flexibility, not a straitjacket of conflicting objectives".

In lieu of binding legislation, we suggest that the RTC oversight board defer to guidelines already issued by bank and thrift regulators on disposition of assets. The Office of the Comptroller, for example, directs national banks to look at the "fair value" of assets, that is, the cash price that might reasonably be anticipated in a current sale.

**225 The principles of "fair value" standard are that a buyer and dealer are each acting prudently, knowledgeably, and under no necessity to buy or sell. "Fair value" is not the value received from a forced or liquidation sale. It represents a price that might be received upon exposure to the open market for a reasonable time, considering the property type and local market conditions.

REVIEW OF PAST CASE RESOLUTIONS

We further note that Section 501 of H.R. 1278 authorizes the Resolution Trust Corporation to review FSLIC-assisted case resolutions since January 1, 1988, with approval of the RTC oversight board. It is clear by the debate which occurred over this provision at both the Subcommittee and full Committee levels, it is the Committee's intent to suggest that case resolution agreements entered into by the Federal Home Loan Bank Board (FHLBB), including the waivers and

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

forbearance, can be reviewed, but are binding and enforceable. Indeed the Committee believes that the Government has the moral and legal obligation to stand behind every element of these agreements.

*329 Section 501 only authorizes a review by the RTC to determine if it should exercise any provision of the agreements which expressly permits modification or early termination thereof. In addition, it was clear from the Committee debate, that the Committee expects that regulation issued pursuant to enactment of H.R. 1278 be consistent with the view that case resolution agreements, including the waivers and forbearances granted in connection therewith are, and should be treated as being, binding obligations of the government, and that such regulations will conform to that view.

THRIFT ACQUISITIONS BY BANK HOLDING COMPANIES

We strongly support the bill's provisions permitting bank holding companies to purchase healthy, as well as unhealthy, thrifts upon enactment of this legislation. These acquisitions would not be limited by the Federal Reserve Board's tandem operating restrictions and we believe that this removes a significant impediment to holding company acquisitions. Bank holding company acquisitions could be a significant mechanism to inject much needed capital into the thrift industry.

We are concerned, however, that certain incentives for bank holding company acquisitions have been reduced by the Committee in the reported legislation. Thrifts acquired by a bank holding company would be subject to the limitations of the Bank Holding Company Act, including certain marketing restrictions. Further, contrary to past regulatory rulings, holding companies will not be permitted to account for the purchases using goodwill in accordance with generally accepted accounting principles. We believe that these factors may unnecessarily provide disincentives for bank holding companies to bring fresh new capital into the industry.

FREDDIE MAC

Finally, we commend the Committee on creating a majority shareholder board for the Federal Home Loan Mortgage Corporation ("Freddie Mac"). A majority shareholder board will give investors the necessary confidence to allow Freddie Mac to continue to raise private funds, not Federal funds, to finance affordable mortgages.

**226 JOHN HILER.
TOM RIDGE.
PATRICIA SAIKI.
AL MCCANDLESS.
STEVE BARTLETT.
BILL PAXON.
DAVID DREIER.
RICHARD H. BAKER.

*330 ADDITIONAL VIEWS OF REPRESENTATIVE TOBY ROTH ON H.R. 1278

In my opening statement when markup began in the Financial Institutions Subcommittee, I stated that tough decisions would be necessary to make this bill workable and fair to the American taxpayer. I pledged to make those hard choices and during the markup I kept the taxpayer's interests foremost. In the end, I voted for the bill as amended despite several remaining concerns. The overriding priority is to pass this legislation as quickly as possible; faced with the steadily worsening situation in the thrift industry, the worst course would be to do nothing. Every month we delay action adds another $1 billion to the rescue cost. The President asked Congress to act expeditiously and we have a responsibility to meet that request.

I continue to have four main concerns about this bill. First, the funding level, as large as it is at $157 billion, probably will not be enough to finish the job of restoring the deposit insurance system and covering the insured accounts. Know-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ledgeable federal officials have told me in recent weeks that 600—not 500—thrifts will have to be taken over and liquidated. Many of these continue to grow in size, only increasing their ultimate insolvency. Moreover, some of the "resolutions" entered into last year by the Federal Home Loan Bank Board already have come apart, just as some of us on the committee predicted months ago. This will add to the cost of the plan. Finally, the assumptions underlying the Administration's cost estimate are unrealistic, such as declining financing costs, and increasing recoveries from liquidations. I had urged more flexibility in the plan to allow the President to meet the real costs of the rescue, but there was not support for that approach. As a result, the Administration will have to come back to Congress for more authority.

Second, the bill's provisions for the Resolution Trust Corporation provide far too little direction and control. The RTC will become the largest corporation in America in terms of assets. Yet the Administration is starting from scratch in creating this organization. Its management will have the most difficult job in the federal government, taking over and selling off some $400 billion in assets from failed thrifts. The RTC will require careful oversight by our committee, and continuing attention from the highest levels of the Executive Branch.

Third, the bill leaves in place the contracts entered into last year by the Bank Board. In many of these arrangements, the Bank Board gave investors guarantees that they would not lose money in taking over failed thrifts. When the nature and scope of these deals became known in late December, I urged the Attorney General to step in and stop these deals, because they are not in the public interest. He declined, leaving the contracts to go into effect. Now we*331 are seeing the true cost of the Bank Board's folly: a minimum of $29 billion in government outlays to those who made off with these guarantees. In this bill I urged that those contracts be reopened, but we only won a halfway measure: a "review" of their terms and costs. This is not adequate.

**227 Finally, I am not satisfied with the provisions for prosecuting those who have contributed to creating this mess, and for recovering as much of the assets as possible that were looted from many failed institutions. We know that 10,000 fraud cases have been referred to the Justice Department in the past two years, but so far only a handful of prosecutions have been won. The Justice Department was unable to give the committee any firm data on the resources devoted to this mammoth law enforcement problem. Yet, the American taxpayer is footing a large portion of the bill for these crimes. I believe that simple fairness requires prosecution of those who defrauded the American people and our government. So far, the Justice Department's response has been far too little.

This bill can be improved in the next stages of the legislative process and I will continue to work for a stronger bill. However, my responsibility as a legislator is to support this measure now, so that we have some response to the growing crisis in the thrift industry. If Congress had acted two years ago, when some of us were stymied in our efforts to pass strong legislation, then this bill may well have not been needed. Because of that failure two years ago, today we have no choice.

TOBY ROTH.

ADDITIONAL VIEWS OF CONGRESSMAN JIM BUNNING

The markup of H.R. 1278, the Financial Institutions Reform, Recovery and Enforcement Act, while providing many substantive changes was clouded in a fog of buzz words. If the FSLIC had been given a dollar for every time the words "stronger", "weaker", "tougher", or "looser" were used in committee, the Savings and Loan problem might be solved.

When all amendments were considered on this bill in committee, if an amendment was couched in terms of "stronger", it passed. If it was "weaker", it lost. However, no one on this committee could disagree that there was considerable confusion as to what, in fact, was "stronger" and "weaker".

For instance, a perception developed that the capital standards adopted by the committee were stronger than the ones adopted by the subcommittee or by the Senate. That is debatable since a flexible date for compliance was added to the standards—a provision that, up until the time of markup, was considered a vetoable item by the Treasury Department.

When this bill is considered on the floor of the House, I urge every member to use his own conscience as his guide to

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

determine what the appropriate standards should be for thrifts. Cast votes on the substance, not on the rhetoric.

*332 One other major task needs to be addressed before enactment of this legislation. In committee, a bill to solve the problems of a sick industry took a turn to solve the problems of the world. In a series of amendments, we added several housing provisions. One provision allows the right of first refusal to certain groups for the property being held by the RTC. The other sets up a tax on the savings and loan industry for subsidized housing.

**228 First, regarding the right of first refusal, no one argues that the savings and loan crisis offers a good opportunity to take some of the property from failed institutions and provide for low-to moderate-income housing stock. However, the amendment adopted by the committee eliminates any discretion to the RTC in granting a "right of first refusal" to public agencies and overturns an agreement to that effect adopted in the subcommittee. The mandatory right adopted by the committee is restrictive, costly and will slow down the pace of case resolution. In the end, it will be a wash to the taxpayer.

Secondly, an amendment was adopted at subcommittee to put a tax on the earnings of the Federal Home Loan Bank Boards and use that money for subsidized housing. Now, I'm sure that some will argue that this is not a tax. However, the simple language of the amendment says that a per cent assessment will be put on net earnings. I can think of no other category of fowl in which to put this assessment than a walking, quacking duck; i.e. a tax.

Under the bill, a large portion of the retained earnings on the Federal Home Loan Banks are dedicated to resolution of the crisis. Now, on top of that we are adding an additional tax for subsidized housing. Considering the taxpayer burden in this bill, this money would be better spent on resolving the crisis. Moreover, states like Kentucky that have a strong, traditional thrift industry are being further punished for the sins of other areas.

Further, the amendment carries with it the baggage of some additional provisions that could not fly on their own under a separate vote. For instance, in the subcommittee consideration of this bill, we struck down an amendment to add two consumer representatives to the local Bank Boards. Mysteriously, this provision reappeared at full committee in the housing amendment. Independent citizens already serve on the Boards by existing law and the subcommittee saw the definition of consumer in this case as an attempt to put members of Washington-type "consumer groups" on local Boards.

I do hope that these two "weakening" amendments are revisited and changed before enactment.

JIM BUNNING.

*333 SUPPLEMENTAL VIEWS ON CAPITAL STANDARDS

We strongly support H.R. 1278, as reported by the Banking Committee. This bill lays a solid foundation for prompt, responsible action to resolve the savings and loan crisis and most importantly to insure a strong viable thrift industry for the future. This measure represents a significant improvement over the Administration's proposal and merits the strong and overwhelming support of the full House of Representatives.

A crucial improvement in H.R. 1278 and a major focus of the Committee's deliberations was the treatment of capital standards. As witness after witness testified to the Committee, lower capital standards, often loosely enforced, were a major cause of the disaster we now face.

**229 Secretary of the Treasury James Brady testified:

> We are experiencing the results today of an industry that collectively has not been adequately capitalized. We have learned a valuable lesson: Deposit insurance simply will not work without sufficient private capital at risk and up front.

This view has been reiterated by many others. Comptroller General Bowsher, in a letter to Chairman Gonzalez and Congressman Wylie emphasized:

> * * * inadequate capital creates incentives for institutions to engage in unsafe and unsound practices. These practices can, and often do, result in losses to the deposit insurance funds. The taxpayer is now facing a problem of unprecedented proportions due, in no small measure, to our prior lack of insistence upon adequate tangible capital requirements.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Adequate tangible capital provides a buffer to protect the insurance funds and, therefore, the taxpayer from loss and instills discipline in an institution's management since it is the owners' own capital which is at risk.

With those admonitions in mind, the Committee has responded admirably. While the Administration placed a proper focus on the importance of stong capital standards, their legislation fell significantly short on that mark. The President, in his proposal, sought new capital standards similar to those applicable to national banks, which implied minimum capital of 3 percent of assets. Included in this 3 percent could be common stock, noncumulative preferred stock, retained earnings, qualified intangibles (up to 25 percent of tier 1 capital) and goodwill (with no limit defined). The inclusion of unlimited goodwill, even on a phased-out basis, presented a major and potentially dangerous loophole in an otherwise sound proposal from the President. Goodwill has for far too long been thrift's bookkeeping legerdemain; it is not real money and does not stand ready*334 to absorb losses that would otherwise fall on the insurance fund and the taxpayers. That the Administration's proposal would have authorized extended and unlimited use of goodwill as capital would have only hidden problem institutions, prolonged our efforts to confront the problem and increased the costs to the taxpayer. While the regulators promised tough standards with minimal allowable good will, this Committee has heard too many empty promises of tough action and standards to rely solely on regulatory discretion. As a result, the Committee has endorsed a detailed capital standards plan that represents significant improvements over the Administration's proposal. Starting one yearr earlier than the Administration proposed, the Committee reported bill phases in higher tangible capital requirements and phases out the use of qualifying intangibles, including supervisory goodwill. Thus by December 31, 1994, thrift institutions will have to maintain a minimum tangible asset percentage, including mortgage servicing rights at a level determined by the FDIC, or 3 percent. That 3 percent level is a solid number and does not permit the inclusion of any goodwill or similar intangibles. It represents real money and will stand as the most important assurance that this crisis will never recur.

**230 The Committee reported bill also improves upon the Administration proposal by specifying the treatment of any savings association not in compliance with the capital standards. The Administration had stated their intent to deal with such institutions on a case-by-case basis. However, their legislative proposal did not explicitly provide them with such authority and did not establish any guidelines upon which the regulatory agencies could make their determinations. H.R. 1278 establishes an explicit procedure for an institution to seek an exemption from sanctions for noncompliance and provides appropriate regulatory agencies with direction and criteria on which to deny or approve exemption applications. While this regulatory flexibility is needed, we believe that it is essential that the Chairman and the Corporation assiduously enforce the noncompliance criteria set forth in the legislation. This provision is not intended to repeat the mistakes of the past by providing blanket forebearance to weak institutions. Rather, it was designed to allow the FDIC a modest amount of flexibility with regards to thrifts that, while undercapitalized, continue to be profitable, sound and valuable contributors to their communities.

But, while the capital standards in H.R. 1278 as reported are tough, fair and effective, they are a compromise. Many Members of the Committee supported the imposition of higher capital standards in a shorter time frame with less regulatory flexibility. Other Members believed that the most effective policy would establish phased in capital standards with more regulatory flexibility. The compromise which the Committee developed is a blend of the best of both positions. The Committee has successfully balanced the needs for tough capital standards with the necessity to recognize that many good institutions need some limited regulatory flexibility to meet those standards.

This compromise allows the regulatory agencies to focus promptly on the weakest of the thrifts. The legislation gives the regulators the ability to close those savings associations which represent a risk to the insurance fund, along with the flexibility to help other*335 thrift institutions to meet the requirements in this proposed new law. The capital standards compromise provides savings associations certainty. The legislation gives them explicit standards and deadlines which they must meet. This certainty allows institutions the time and the opportunity to develop rational plans and targets and the flexibility to raise any needed capital over time. In addition, the compromise also provides institutions with an opportunity to seek exemptions from noncompliance sanctions and sets forth the criteria which must be met.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Most importantly, the capital standards compromise provides the taxpayer with the critical protection that was lacking in the past. These standards and their enforcement will result in a healthier thrift industry, increased consumer confidence and a strong buffer to protect the insurance fund and the taxpayer from losses.

**231 BRUCE F. VENTO.
MARGE ROUKEMA.
BRUCE A. MORRISON.
RICHARD E. NEAL.
TOM CARPER.
CHARLES E. SCHUMER.
RICHARD LEHMAN.
GERALD D. KLECZKA.
NANCY PELOSI.

SUPPLEMENTAL VIEWS CONCERNING FORBEARANCES FROM INDUSTRY–WIDE CAPITAL STANDARDS

We strongly endorse the Financial Institutions Reform, Recovery and Enforcement Act of 1988 as reported by the Committee on Banking, Finance and Urban Affairs. In particular, the capital requirements established in the bill are a remarkable achievement and will ensure that the thrift industry remains strong, viable, profitable, and—most important—safe and sound in the future. Capital serves as a cushion, ready to absorb losses that would otherwise fall to the insurance fund and the taxpayer.

Extensive debate surrounded the development of these requirements, and in particular the issue of whether certain thrifts should be exempted from these tough standards by authorizing them to include noncash items such as supervisory goodwill or deferred loan losses in capital. The Committee voted consistently to establish a universal standard, requiring all insured thrifts to have sufficient capital at risk, determining that the imperative to ensure a safe and sound financial system took precedence.

However, a significant number of thrifts have been granted exemptions from even the current weak capital standards as a result of potentially ill-conceived forbearances from the Federal Savings and Loan Insurance Corporation. These capital forbearances have been understandably attractive to potential buyers of troubled thrifts for they allow them to operate with little if any private capital at risk, which is both potentially more profitable to the owners and certainly much more of a threat to the insurance fund and the*336 taxpayers. That threat turned into a $100 billion expense for the government and could likely pose a substantial cost in the future as well. Undercapitalized thrifts simply have no incentive not to take massive risks with insured deposits.

Section 501 of the bill requires the Resolution Trust Company to examine the transactions undertaken by the FSLIC and, where possible under applicable law, to take steps to minimize the cost to the government. An amendment to Section 501 of the bill which would have made explicit the duty of the RTC to examine capital forbearances in particular in the course of its overall review of previous assistance transactions was defeated to a large extent because many members of the Committee felt that the existing language was sufficient to authorize the RTC to take any necessary actions. That the RTC carry out that duty to review and where appropriate revise or terminate capital forbearances is crucial to achieving the key objective of this legislation: that such a devastating crisis never be allowed to happen again. As has been proven so clearly in this crisis, we cannot afford to allow any thrifts to operate without restraint without adequate private capital at risk.

**232 The RTC and, if appropriate, any other regulatory agency, has the clear authority to take any action it deems appropriate. The new capital standards embodied in the bill reported by the Committee are intended to apply to each and every thrift equally and without exception and, when enacted into law, will replace both the previous standards themselves and any exceptions that may have been granted where appropriate. Moreover, the regulators have the clear author-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ity, and indeed the responsibility, to take action to resolve situations which pose a threat to the safety and soundness of an insured institution. Inadequate capital has been proven in this crisis to be a devastating threat to the financial system as a whole.

In the case of capital forbearances, an overriding public policy would be jeopardized by the continued adherence to arrangements which were blithely entered into by the FSLIC. It is essential that in making available the massive sums of money necessary to deal with this difficult problem we take the crucial steps to reform the system to ensure that this crisis never recurs. In general, the bill reported by the Committee takes those important and difficult steps by establishing firm capital requirements that demand that private money, not the taxpayers', be at risk and provided general authority for the RTC to review and terminate as appropriate any capital forbearances. However, the Committee failed to specify the responsibility of the RTC to examine these forbearances carefully. The specific duty to carefully review these dangerous loopholes is an important component of the total legislative solution to this difficult problem and should be included in the final version.

CHARLES E. SCHUMER.
BRUCE A. MORRISON.
MARGE ROUKEMA.
HENRY B. GONZALEZ.
BRUCE F. VENTO.
C. THOMAS MCMILLEN.
PETER HOAGLAND.

*337 SUPPLEMENTAL VIEWS ON LOW –INCOME HOUSING PROVISION IN H.R. 1278

We strongly support the provisions of H.R. 1278 that will reinvigorate the special role that thrifts have been given since their inception to provide credit for the housing of Americans. H.R. 1278 is markedly improved by the inclusion of specific support of cash advance windows to support mortgages for low-and moderate-income housing and the provisions to require the right-of-first-refusal to non-profits and low-income persons for properties owned by insolvent S & Ls.

With the enactment of the Federal Home Loan Bank Act in 1932, the Conference Committee wrote, "The home loan bank system will serve the wage earner and people in the humbler walks of life, through serving those institutions which are devoted to helping them accumulate their savings for the "rainy day" and also helping them to own their own homes." We remain committed to those sentiments, today, in 1989.

We are greatly concerned about the situation being faced by millions of people in this country with regard to housing. Given the monumental cuts in federal housing assistance totaling over 70 percent in the past eight years, we must make every effort to provide access to capital, to leverage other monies, and to assist in property acquisition, in order to stave off the ever-increasing housing crisis that would certainly top that in which we find ourselves today.

**233 A report was issued on April 17, 1989 by the Center for Budget and Policy Priorities and the Low Income Housing Information Service entitled "A Place to Call Home: The Crisis in Housing for the Poor". This timely report has underscored the significant crisis faced by low-income Americans trying to obtain affordable housing. According to the report, some 45 percent of all poor renter households—over three million households—paid at least 70 percent of their incomes for housing while sixty-three percent paid 50 percent or more for housing in 1985.

The report also found that the crisis is immense for low-income homeowners. Thirty-one percent of poor homeowners spent 70 percent or more of their income for housing and 46 percent of poor homeowners paid 50 percent or more of their income for housing in 1985. These are the households at an extremely high risk of becoming homeless. They are also the households that will benefit greatly from the properties held by insolvent S & Ls.

The FSLIC controls about 5,000 properties worth an estimated $5 billion with an additional $754 million in loans moving toward foreclosure. These properties are not only a wasted asset, they are financial drains on an already strained sys-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

tem because they require management and upkeep in order to be resold.

We strongly support the provision to require the Resolution Trust Corporation to offer the right-of-first-refusal on a three-*338 month option to low-income people and non-profits organizations so that they may buy low-priced properties owned by insolvent S & Ls. With highly effective non-profit organizations like those under the Neighborhood Reinvestment Corporation, these available properties will be leveraged to their highest potential of providing rental and homeownership opportunities to low-income families. It has been estimated that this plan would only affect $2 to $3 billion of the $200 to $300 billion in real estate the government will inherit from failed S & Ls.

We are very pleased at the inclusion of improvements in the cash advance windows of the Home Loan Banks to assure support for critically needed low- and moderate-income mortgages. In the late 1970's, under the Carter Administration, the Federal Home Loan Bank established the Community Investment Program. This program was a successful stimulus for community development initiatives. Unfortunately, the Community Investment program has been underutilized during the past eight years. It is our belief that the banks should refocus their attention on the community support program. The adherence to minimum standards, including the criteria listed by the legislation, is aimed at accomplishing the goal of maintaining eligibility for access for advances.

Providing a separate affordable housing window to administer advances to member institutions making loans and providing a specific structure for Community Investment funds is essential. The assessment on the net earning is modest, nevertheless, it will have a sizable impact on affordable housing throughout the nation. This program will work to combine these monies with other private and public funds available locally to make projects work to the benefit of communities that have been hit hard by the housing crisis.

**234 It was our intent that the subsidization of the cash advance windows would focus a lender's priorities on the purchase, rehabilitation, or construction of multi-family rental housing. No less than forty percent of the housing would be occupied by low- or moderate-income households. In addition to prioritizing non-profit housing and state or local housing authority housing projects, the cash advance program would also emphasize the purchase or rehabilitation of housing held by the United States Government or any agency or instrumentality of the United States. These provisions, in combination with an active advisory council at each bank, should result in a modest, yet effective program that will utilize this opportunity to increase low- and moderate-income housing activities across the nation.

It was unfortunate that the provisions to strengthen the disclosure provisions of the Community Reinvestment Act and the Home Mortgage Disclosure Act were not included in this bill. These modest public disclosure amendments are needed to help ensure that financial institutions remain viable and active members of the communities in which they serve.

BRUCE F. VENTO.
RICHARD E. NEAL.
NANCY PELOSI.

*339 SUPPLEMENTAL VIEWS CONCERNING THE BUDGET TREATMENT OF THE FINANCING FOR THE THRIFT PLAN

The Financial Institutions Reform, Recovery and Enforcement Act of 1989, as reported by the House Committee on Banking, Finance and Urban Affairs adopts essentially intact the Administration's plan to finance the resolution of the savings and loan crisis. Under this plan a new, ostensibly off-budget government sponsored enterprise, the Resolution Trust Corporation ("REFCORP"), would be created to sell or liquidate the estimated 500 thrifts that are expected to fail. To finance the bulk of the thrift resolution costs REFCORP would issue $50 billion in long-term bonds. The principle on the bonds would be repaid with contributions from the Federal Home Loan Banks and other sources which would be used to purchase thirty year zero coupon Treasury bonds. After the first few years, nearly all of the interest costs (which would comprise nearly 90 percent of the total cost of the financing) would be paid by the Treasury.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The Administration's financing plan is understandably alluring in this period of large budget deficits. Treating REFCORP as an off-budget entity has the perverse effect of transforming $50 billion in borrowings (which would have increased the deficit) into $50 billion in "collections" (which actually would decrease the apparent deficit). This would enable the Administration to avoid making the Gramm–Rudman–Hollings deficit reduction targets unattainable, while still allowing the Administration to allocate the billions in taxpayer funds necessary to resolve this urgent crisis.

Unfortunately, the Administration's financing plan is substantially more expensive than an on-budget alternative. Because REFCORP would be a "private" corporation and not a government agency, the bonds it issues would not be backed by the full faith and credit of the United States. As a result, the interest rate on the bonds would be significantly higher than the interest rate on bonds issued directly and guaranteed by the U.S. government. Using the Administration's own modest estimate of $50 billion to close and liquidate the insolvent thrifts, off-budget financing is expected to cost at least $150 million per year more than on-budget financing or $4.5 billion more over the life of the bonds. That extra cost would be borne exclusively and directly by the taxpayer.

**235 The Administration apparently considers the added cost a worthy expenditure of taxpayer funds necessary to keep the borrowing from appearing in the calculation of the deficit and triggering Gramm–Rudman–Hollings. The Administration chose this course even though several on-budget alternatives were—and continue to be—available. Any of these alternatives is clearly preferable to the Administration proposal because they would save the taxpayer hundreds of millions each year, money which could otherwise be utilized to reduce the deficit or to fund the incredible*340 number of deserving programs and proposals that have withered in recent years.

These on-budget alternatives would reflect the reality of this situation that it is the government, and not some off-budget "private" corporation, which is borrowing massive sums of money to carry out a governmental purpose in resolving the thrift crisis. Just as the Administration's proposal exempts the borrowing from Gramm–Rudman–Hollings by placing it entirely off-budget, on-budget alternatives would require either an explicit or implicit exemption from the deficit calculation, and it is appropriate that expenditures such as the rescue of the savings and loan industry be placed outside of a process designed to curtail spending on current consumption.

Not only would an on-budget approach save the American taxpayer hundreds of millions of dollars each year, it would make the financing process substantially less cumbersome and cut the swarm of private and quasi-private entities created by the Administration proposal down to just one. Moreover, without that thicket of fictional private corporations, the federal government would retain direct control and oversight of an operation designed to raise $50 billion, liquidate or sell hundreds of insured thrifts holding more than $150 billion in assets, and protect the government's financial and policy interests.

Proposals to place the funding on-budget were offered during consideration of the bill by the Committee and received the vocal support of a large number of the members of the Committee. However, as most of these proposals involve issues which span the jurisdictions of a number of committees, all of these amendments were deferred.

Support for a cheaper and less convoluted on-budget financing scheme includes the Congressional Budget Office, the General Accounting Office and numerous market and finance experts. In addition, it has been endorsed by the New York Times, the Washington Post, and the Wall Street Journal. As the Washington Post stated in an April 10, 1989 editorial:

> Congress could deal with the S & L fiasco directly and honestly. * * * The S & L money's gone. * * * The government is already legally obligated to fill that hole. Why not just acknowledge that truth, and finance the consequences in the cheapest and simplest way available—on the budget?

Given the staggering cost of the bailout, we owe it to the taxpayers to finance the resolution of this crisis in the most efficient and least costly manner available. On-budget financing will result in substantial savings over the Administration's proposal. Such an alternative would improve government oversight of the financing and resolution activities and would retain every dollar of private funds that would be contributed under the Administration plan. When the full House meets to consider this legislation, I hope that it will adopt such an important and needed change.

**236 CHARLES E. SCHUMER.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

*341 SUPPLEMENTAL VIEWS OF BILL McCOLLUM

The extreme difficulties of the thrift industry are well known. This legislation is a solid effort to address both the need to provide large new resources to the insurance fund to protect depositors and resolve the status of troubled and unhealthy thrifts, and the need to fundamentally restructure the thrift industry and its regulators to avoid a recurrence of happenings which led to and exacerbated this thrift crisis. Building on the foundation of President Bush's proposals the Committee legislation proposes to significantly raise the capital requirements for thrifts and strengthen and streamline the regulatory system. While there are some provisions in the legislation with which I disagree, overall I think this is a remarkably good piece of legislation for its intended purposes.

A few provisions need further comment. Under Section 314 of the bill, all thrifts not exempted will be required to deduct their investments in and loans to subsidiaries engaged in businesses in which national banks are not permitted to have subsidiaries engaged when determining whether they meet the capital standards required under this bill. Thrifts will still be allowed to own subsidiaries engaged in such activities as real estate and insurance as they are under current law, but they will not be able to count their interest in these subsidiaries toward their capital requirements. This restriction comes from understandable concerns that some of the activities of existing subsidiaries caused or significantly contributed to the difficulties of sick thrifts. The evidence is clear that there have been many abuses in the industry related to some of these subsidiaries including the double counting of capital which resulted in very misleading statements on the financial condition of basically insolvent institutions. For whatever reasons, the regulators have not been able to keep up with these problems, and for the future, I agree with the Committee decision to put up a wall between the thrift and subsidiaries engaged in these riskier businesses by not allowing them to count their investments towards their capital.

However, there are quite a number of well-capitalized and healthy thrifts which have subsidiaries engaged in these businesses, and placing this new capital restriction on them would as a practical matter force them to divest themselves of these subsidiaries at probably less than favorable market prices in order to meet the new capital requirements in this legislation. For this reason, I proposed and the Committee adopted an exemption from the capital deductibility provisions on investments and subsidiaries for these healthy and well-capitalized thrifts so long as the regulators do not find their subsidiary activities to be a risk to the safety and soundness of the parent institution. This grandfather provision is found in Section 219(6) of the bill and specifically limits the grandfathered thrifts' investments in such subsidiaries to the current*342 amounts and does not allow any growth in these investments. Furthermore, the consolidation provisions found in Section 314(c) eliminates the problem of double accounting by requiring for these grandfathered institutions that the assets and liabilities of the parent thrift be consolidated with the assets and liabilities of the subsidiaries when determining whether capital requirements have been met.

**237 Section 315 of this legislation limits the ability of state-chartered thrifts to engage directly in equity investment activities not permissible for federally-chartered thrifts. It is clear from the debate in Committee and from the language of Section 315 when read in context with the other provisions of this legislation that the Committee does not intend to apply the restrictions of Section 315 to thrifts and their investments in subsidiaries exempted under Section 219(6).

Under present law a federal savings association may offer checking accounts to a business only if it has a credit relationship with the business. Section 306 of this bill would allow the Office of Thrift Supervision to authorize federal savings associations to offer demand deposits to all their customers. The existing general prohibition against the payment of interest on demand deposits accounts would be retained. This amendment is identical to a provision contained in legislation passed overwhelmingly by the Senate in the Ninety-eighth Congress (S.2851).

Business checking accounts are a low-risk means for thrifts to increase their income and their ability to generate capital internally. Since by law they pay no interest, they are a relatively low-cost source of funding. Studies have shown that noninterest-bearing business checking accounts are highly profitable for banks. One recent study concluded that the higher earnings of larger banks compared to comparable thrifts is attributable to the banks' relatively inexpensive noninterest-bearing checking accounts. Similarly, thrift branches now must have significantly larger deposit bases than banks to be

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

economical, because deposits at thrift branches currently are overwhelmingly composed of more expensive interest-bearing retail accounts.

Under H.R. 1278, thrifts will be required to conform to capital standards no less stringent than those applicable to national banks. This legislation will also require thrifts to concentrate on less risky, and thus less profitable, lending and investment activities. At a time when thrifts are being forced to bear capital burdens comparable to banks, it is appropriate to permit thrifts to engage in low-risk deposit activities that will help them generate the increased earnings needed to meet and maintain the higher capital levels.

Thrifts already offer checking accounts to businesses with whom they have a lending relationship, as well as NOW checking accounts to consumers, nonprofit organizations, and governmental units. They therefore have operating systems in place to support the offering of checking accounts to businesses generally. The additional expenses to offer general business checking accounts thus should be small.

There is one part of this bill with which I strenuously disagree. Under present law, thrifts like commercial banks are prohibited*343 from cross marketing and tandem operations with their subsidiaries. This legislation would remove this prohibition with respect to thrifts. Allowing thrifts to cross market could easily result in a few very large and healthy institutions and their subsidiaries being able to drive out of the market some existing small businesses and impact in a very negative way the profitability of many others. The basic thrust of this change is to encourage "one-stop shopping." A larger thrift with varied subsidiaries in real estate, title insurance, etc. will capture the homebuyer under its business roof for every aspect of the purchase. Because of the integrated nature of the businesses, the thrift institution and its subsidiaries will offer rates and special deals that a customer simply cannot find anywhere else. Arguably this is in the consumers' best interest, but the pluses are outweighed by the minuses when one thinks about the consequences in terms of the concentration of financial power under ever-increasingly fewer roofs and the probability that at some point in the future this will lead to less competition rather than more and higher prices and cost rather than lower. At some point in this process the prohibition on cross marketing and tandem operations should be restored.

**238 The scope, size and complexity of this legislative undertaking are staggering. The expertise of Committee members and staff working on this legislation undoubtedly has been inadequate to the task. But this legislative product represents a tremendous effort on the part of those involved and is the best product that one could expect under the circumstances. Undoubtedly some refinements will be made on the floor and agreements will have to come between the two bodies in conference, but even then there can be no assurance that the efforts of this legislation will prevent a recurrence of all the problems which have led to the current thrift crisis. Hopefully, the changes made here will allow the thrift industry to survive and over time to grow and regain its prominence as the provider of home financing in this country with a limited number of future difficulties.

BILL McCOLLUM

*344 INDIVIDUAL VIEWS OF REPRESENTATIVES RICHARD H. BAKER

H.R. 1278, as reported by the House of Representatives Committee on Banking, Finance and Urban Affairs, is an extremely important congressional response to the problems facing our country's thrift industry. Although I voted to report the bill from committee to the full House for debate, I have serious concerns with the potential impact of the proposed legislation.

All members agree that the problems facing the industry result from two principle difficulties. The first is abuse of the fiduciary responsibility through mismanagement, speculative investment practices, and regrettably even criminal acts. Individuals should be held accountable and accordingly, $75 million is made available to the Department of Justice to prosecute those who are responsible. I strongly support this effort.

The second element of the problem was brought on by regional economic distress and depression of real estate values. Properly managed thrifts, lending principally for single family residential purposes, have seen portfolios shrink and

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

losses increase.

The solution to this problem is securing capital by finding methods to increase profits from streamlined operations or by securing outside investment. The industry will recover only when sufficient capital is secured.

Obviously, minimizing the use of taxpayer dollars for this purpose is essential. Institutional performance should be reviewed on a case by case basis, and only in the instance where regulators determine management has acted professionally should assistance be made available. The ability of an institution to continue to operate as a qualified thrift lender should also be predicated on the conclusion that it is the least expensive of the various alternatives available to the regulators.

To encourage recovery as quickly as possible, every sound, responsible investment activity currently authorized should be maintained to attract capital. Standards of accountability should be improved, and capital standards reasonably adjusted upward.

**239 In consideration of the foregoing expressed concerns, the committee amended version of H.R. 1278, does not resolve the thrift industry's problems.

The bill raises capital standards quickly with no consideration given for special accounting privileges granted on a case by case basis by regulators. Insurance premium costs are raised substantially and operating costs are increased as the result of increased regulatory oversight. In addition, direct investment activities of subsidiaries is eliminated over time. Institutions must maintain 80 percent of their assets in qualified assets or they lose their Qualified Thrift Lender status.

*345 In many areas of the country real estate values are depressed. The ability to dispose of repossessed assets for a reasonable rate of return is diminished.

Some institutions in Louisiana, for example, which currently exceed minimum capital requirements, engage in lending practices which will no longer be permissible under the provisions of the legislation. The principle thrust of the legislation is to encourage single family residential lending, which at the current time is most difficult to perform and make a profit. Institutions that are most profitable are those with a diversified portfolio and yet these investment practices may no longer be permissible.

Additional burdens on the bottom line are also of concern. A new housing initiative, financed through assessments on the regional Federal Home Loan Banks, will cost at least an additional $650 million. A provision to require a right of first refusal for low-income individuals, before regulators can dispose of certain residential property, will make it more costly to the taxpayer.

In summary, responsible management of troubled thrifts should be given reasonable opportunities to minimize cost to the taxpayer. Mismanagement and criminal wrongdoing should be prosecuted to the full extent of the law. An analytical review on objective standards should be made on a case by case basis to insure minimal cost to taxpayers, minimal closure of institutions and return of depositor confidence. Resolution of this crisis is essential to the stability of financial markets and economic prosperity.

In conclusion, I urge that each member carefully consider each provision of this legislation.

RICHARD H. BAKER.

*346 DISSENTING VIEWS OF HON. MARCY KAPTUR

The collapse of the savings and loan industry provides yet another glimpse of our capacity as a government "of the people, by the people, and for the people" to ignore the people—that is, until we have to find someone to pay the bill. The American taxpayer did not cause the savings and loan crisis. Yet, the Bush Administration legislation will cost the taxpayer a minimum of $100 billion dollars over the next 30 years to fund an "off budget" bond financing scheme to resolve troubled thrifts. Some estimate the cost to the taxpayers could rise as high as $300 billion depending on what happens to interest rates and the health of savings and loan institutions in the future.

**240 In fact, the Bush Administration "bond" proposal is a delayed tax scheme that will begin kicking in in 1991, at a rate of $4 billion per year for 30 years to pay the interest costs on the new bonds issued. Where will the annual $4 billion

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

dollars come from to pay the interest on the bonds? Where will the $120 billion in interest over 30 years come from? Whose taxes will be raised to make these payments? Which budget accounts will be short changed as a result—education, health care, veterans, defense? No one in the Executive Branch wants to answer these questions.

Incredibly, this bond scheme—which is actually a hidden tax—is being done in the name of fiscal responsibility—i.e. to meet Gramm–Rudmann–Hollings budget targets. Yet if Congress would put the bailout on-budget and pay for it over the next three years, the cost to the public would be cut by nearly two-thirds. A special exemption to Gramm–Rudman–Hollings could be legislated since it never was intended to accommodate the one-time financial crisis that we now face.

If the bailout is placed on-budget, an equitable financing plan must be developed which places the burden on those most responsible for causing the problem. The average taxpayer is not guilty. States in certain regions of our nation that permitted their state-chartered institutions to engage in excessively risky activities must be made to pay their fair share. The Kanjorski/Kaptur amendment that was defeated in the Financial Institutions Subcommittee would have raised $4.5 billion from these negligent states.

The financial services industry, financial intermediaries and certain individuals that took advantage of high interest rate, brokered deposits also should pay their fair share of the bailout. Special taxes could be assessed on these groups for a limited time period to help fund the bailout.

If the Bush Administration off-budget tax scheme must be used, the interest payments on the bonds should at least be structured to benefit the American taxpayer. The operative question should be: How can the bond offering be structured to benefit the American public which will pay the tab for this "debacle of deregulation with*347 lax examination." My amendment adopted in Full Committee to lower the face value of bonds sold to $1,000 (from the Bush proposal of minimum face value $10,000) is one step to make the bond offering more available to our citizens. But why should U.S. taxpayers pay billions of dollars in interest payments over 30 years to foreign investors—who are the most likely buyers of these bonds—when the American taxpayer is being asked to fund the bailout? My amendments defeated at the Full Committee gave the Treasury an incentive to sell the bonds to the U.S. public first by limiting to 10% the amount foreign creditors could purchase in the first 18 months of the bond offering. I also proposed a report back to Congress on which foreign creditors buy these bonds and to whom Americans thus owe principal and interest. Americans have a right to know to whom our financial system is indebted.

**241 Finally, in any acceptable solution to the S & L crisis, reinvestment must take place in communities which have faced lending discrimination. It is a pathetic commentary on those who steered the S & L industry down this dead-end path that deposits flowed out of communities that were redlined in order to pay for risky investments made far from home by institutions that manipulated small depositors funds. It is sad public policy that this Committee did not pass the Gonzalez/Kennedy amendments to strengthen the Community Reinvestment Act and the Home Mortgage Disclosure Act to make restitution to those who have been discriminated against.

I believe that the enforcement provisions of this legislation go a long way to assure that this thrift debacle will never occur again. But in solving the present crisis, I believe this legislation failed miserably in proposing a fair financing mechanism to give American taxpayers something for their money—namely, fairness.

MARCY KAPTUR.

*348 DISSENTING VIEWS OF JOSEPH P. KENNEDY II

Although the bill reported out by the Banking Committee addresses many important issues to which I subscribe, I am obliged to register my dissent for the following two fundamental reasons. One, the bill fails to provide for measures that can assist in ending discrimination in loan provision to citizens who want to buy their own homes—citizens who are asked to bear the burden of bailing out the savings and loans (S & Ls). Two, the funding mechanism for the S & L bailout unduly burdens the average taxpayer.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

In 1933 and 1934, the Federal Home Loan Bank Board was created to charter, to make credit available and to insure S & Ls in order to promote homeownership in our country. It was an invention designed to meet the United States' commitment to provide decent, affordable housing for all citizens. However, despite legal requirements to the contrary, depository institutions often fail to make their credit facilities available to all potential borrowers, especially low-and moderate-income borrowers, on a non-discriminatory basis. A January 1989 study of 3,100 S & Ls across the country revealed that it is twice as hard for black and Hispanic families to get a home loan as it is for their white neighbors. That is a fact we cannot ignore. As Mr. Henry Gonzalez, chairman of our Committee, has said during our deliberations, there is no greater burden than "the burden of discrimination." Consequently, I cannot accept the argument that it is right to tax all Americans to pay for the fraud and misconduct of the S & Ls, but that it is "not relevant" that Congress give those same taxpayers equal access to credit from banks, S & Ls and mortgage companies. I do not think the United States Government ought to stand by idly while a federally-subsidized industry systematically denies credit to black and Hispanic Americans.

One way of reducing discrimination would have been to provide the public with the means by which to evaluate the performance of local banks and S & Ls in community reinvestment. This could have been achieved simply by requiring federal regulatory agencies to publicly disclose the ratings and evaluations that they give to banks and S & Ls under the Community Reinvestment Act (CRA). This requirement does not impose any new reporting on financial institutions of any kind, it does not change the substantive requirements of CRA and does not mandate any change in the way the rating system works. It does not reform the process through which the public participates in the CRA evaluation process nor does it link CRA ratings to bank applications for new powers.

**242 Last year, this measure was approved by our Committee with very little controversy, and both regulators and industry groups indicated at that time that ratings disclosure was acceptable to them. This measure contains the same safeguards for confidential sources and statements. There was no compelling reason why our Banking *349 Committee could not have adopted it again. Its adoption would have provided public information on the extent to which depository institutions are meeting the credit needs of local communities. It would have provided a meaningful and highly effective method for communicating the community's needs, the institutions CRA plans and the goals to address those needs and their record of accomplishment in meeting their objectives.

This measure would not only have provided the public with the means to evaluate banks and S & Ls, but would have increased the accountability of regulators for the ratings that they give to individual institutions.

An additional way of reducing these discriminatory practices would have been to expand the Home Mortgage Disclosure Act (HMDA) in several significant areas. The current HMDA structure requires disclosure of loans originated by geographic area. However, it does not provide information on who applies and who is rejected for home mortgage credit. It does not cover all lenders. It does not reveal a borrower's race, gender, income, or credit worthiness. We had introduced an amendment to rectify these shortcomings. The amendment required mortgage lenders to report the number of applications they receive by categories of race, income and gender, and to report the number of applications they reject by the same categories. This would have helped the public to compare the rate of rejection of borrowers of different races, income classes and gender.

The amendment would have improved the enforcement of CRA, the Equal Credit Opportunity Act and the Fair Housing Act. It would have given us a more accurate picture of lending patterns and the underlying reasons for denial of credit. Lenders who have nothing to hide had nothing to fear from the adoption of the measures.

Furthermore, I believe it is wrong to finance the thrift bailout through the sale of bonds whether on or off budget. The sale of bonds would increase the cost at least by $5 billion, a cost needed to pay the annual interest on the $50 billion in bonds. Over the 30 year life of the bonds, the sale would create a taxpayer burden of at least $150 billion—a burden that will be shifted to future generations. The additional borrowing would expand the federal deficit and force additional deep cutbacks in domestic programs. I believe that the bailout should be borne by the current generation and should be self-financing through new revenues. Every new program in Congress these days is held to a rigorous standard of

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

"self-financing." The President himself insists that every new expenditure be balanced by an offsetting revenue source, every new proposal is supposed to pay for itself. The S & L bailout should not be handled differently.

**243 The bill would put the main burden of the bailout on all taxpayers. But the average taxpayer will not benefit from this bailout. The average American only has about $2,600 in the bank, so the federal insurance guarantee of $100,000 primarily benefits wealthy Americans, not the average citizen. I agree that the credibility and credit worthiness of the United States Government must be strengthened and protected so that people will in the future continue to rely on it. People who have risked their funds up to $100,000 *350 relying on the federal deposit insurance guarantee should be paid. However, Congress and the Administration should show enough leadership and courage to tax the present generation and put the burden of the bailout squarely on the shoulders of those who are most able to pay and benefit most from federal deposit insurance.

For this reason, it makes better sense to finance the bailout from the following sources:

Extending the 33 percent tax bracket to very high-income individuals ($240,000 for family of four) would raise approximately $17.4 billion over a three-year period.

Raising alternative minimum tax for corporation from 20 percent to 25 percent would raise $13.5 billion over a three-year period.

Taxing appreciated capital gains at death would raise at least $11.3 billion over a three-year period.

In addition to these new revenues, another $6 billion could come from the S & L industry itself. This resource would be raised from increased federal deposit insurance premiums and the retained earnings of the Federal Home Loan Banks. This revenue, instead of being used—as envisioned under the bill—to pay for a small part of the enormous interest costs, would go directly toward the cost of the bailout.

The four sources enumerated above could have raised at least $48.2 billion, which would have almost covered the cost of the bailout. This self-financing plan would have enabled the House to strike the bonding authority from the bill.

It is unfortunate that our Banking Committee did not consider the merit of this issue because of a procedural technicality, that of not being germane to the bill.

To sum up, I cannot with clear conscience subscribe to a bill that puts sizable financial burden on the average taxpayer and that does not attempt to alleviate the heavy burden of discrimination of a large segment of our citizens who are called upon to share in that financial burden.

JOE KENNEDY.

(Note: 1. PORTIONS OF THE SENATE, HOUSE AND CONFERENCE REPORTS, WHICH ARE DUPLICATIVE OR ARE DEEMED TO BE UNNECESSARY TO THE INTERPRETATION OF THE LAWS, ARE OMITTED. OMITTED MATERIAL IS INDICATED BY FIVE ASTERISKS: *****. 2. TO RETRIEVE REPORTS ON A PUBLIC LAW, RUN A TOPIC FIELD SEARCH USING THE PUBLIC LAW NUMBER, e.g., TO(99-495))

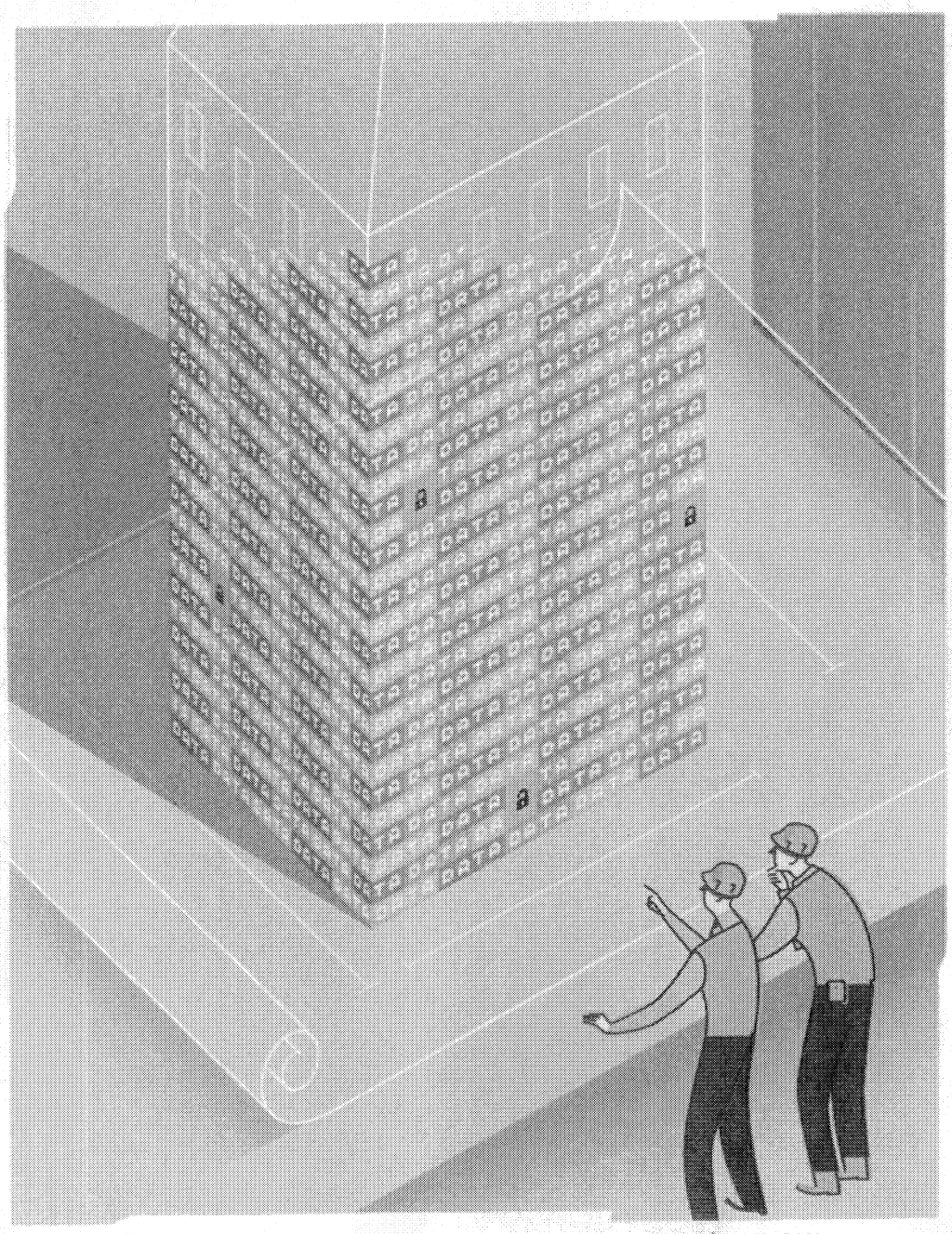
H.R. REP. 101-54(I), H.R. REP. 101-54, H.R. Rep. No. 54(I), 101ST Cong., 1ST Sess. 1989, 1989 U.S.C.C.A.N. 86, 1989 WL 168164 (Leg.Hist.)

END OF DOCUMENT

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

APPENDIX A.4

SETTING THE RECORD STRAIGHT ON MERS



BY ALLEN H. JONES

The foreclosure crisis ignited a media firestorm around the legitimacy of an electronic registry built by the industry to track ownership of mortgages and servicing. It's taking a while to get to the truth.

It has been decried as a shell corporation. Deemed a destroyer of the Colonial-era land-records system. Its most outspoken critics have argued its very existence marks the demise of the institution of property rights. ■ Despite the unforgiving censure of Reston, Virginia–based Mortgage Electronic Registration Systems Inc. (MERS) in the media, its right to exist, to hold legal title to a mortgage and to foreclose all have been maintained by numerous local and state courts. ■ These decisions, along with recent organizational transformation and procedural changes within MERSCORP Inc., MERS' parent company, could mean the storm of litigation challenging its standing is finally tapering off. But MERS remains largely misunderstood by the public, and is almost regularly berated by the media. ■ As a result, politicians are distancing themselves from MERS. Do such maneuvers indicate awareness of a potential liability or is it simply that the public relations risk is just not worth the cost?

Amidst the din, it is hard to tell. Absent from most of the discourse is an unbiased portrait of MERS, with a history of how and why it emerged, the value it confers to the mortgage lending supply chain and the real problems it faces today with respect to a recent regulatory consent order.

The MERS® System is the registry operated by MERSCORP. MERS is a wholly owned subsidiary of MERSCORP. References in this article to MERS are to the subsidiary. The subsidiary's sole purpose is to serve as beneficiary or mortgagee in the land records, while the electronic registry was designed to track the transfer of beneficial ownership interests in and servicing rights to mortgage loans.

Where things stand

As the summer approaches, the housing finance industry is anticipating significant changes in housing policy designed to mend the loose practices that steered Fannie Mae and Freddie Mac into conservatorship. As the administration and Congress attempt to wind down the mortgage giants and attract private capital back into the markets, the inventory of homes for sale and pending shadow real estate–owned (REO) inventory continues to remain at record levels. In fact, the backlog of delayed foreclosures positions the economy to face a new record volume of foreclosures in 2011.

It was the spike in foreclosure activity in 2009 and 2010 that revealed false affidavits and other improper paperwork tied to foreclosures.

Some were carried out by "robo-signers." Others were executed with improper documentation. A few had even been carried out on the wrong house altogether. The discovery became the catalyst for a national foreclosure processing crisis that prompted several large servicers to temporarily suspend their foreclosure proceedings.

On some of those properties foreclosed with improper or incomplete paperwork, MERS was listed as the mortgagee or beneficiary of record. As a theretofore relatively unfamiliar entity, with the power to foreclose, the mortgage lien holder (MERS) unwittingly fanned the fires of the foreclosure crisis. Though numerous court rulings have since vindicated MERS, recognizing its authority to foreclose, many parties remain unconvinced.

During a self-imposed foreclosure moratorium, servicers revisited their loss-mitigation procedures and default-management practices. After conceding the challenges, many servicing institutions announced that additional remedies had been implemented to ensure that borrowers in default are evaluated for all available loss-mitigation options.

Further, servicers pledged that in the event of a foreclosure, their internal reviews had resulted in new operational procedures that would be meticulously followed in the future. But the consternation and uproar caused by the so-called Foreclosure-Gate has not yet fully settled.

That's not to say MERS has not been without some serious setbacks. On April 13, the results of an interagency horizontal examination conducted by federal regulators were released to the public. The report revealed a concerted effort by the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS) to review the safety and soundness of mortgage servicing and foreclosure processes at 14 major mortgage servicers as well as a number of third-party vendors that provide significant services to lenders and servicers—including MERSCORP and MERS. The review has resulted in a formal consent order against the two entities.

This article reviews the establishment of MERS, documents its founding premise, explores how it has been used since 1995, evaluates its real impact on the foreclosure crisis, considers the impact of the consent order and shares a perspective on MERS' continued role in the future. The hope is that by providing this account the record will be set straight.

Background

Originally conceived in the late 1980s, the concept for an electronic clearinghouse of critical mortgage information was explained in an October 1993 white paper entitled the *Whole Loan Book Entry [WLBE] Concept for the Mortgage Finance Industry*. The idea was developed by the InterAgency Technology Task Force (IAT), a group composed of prominent industry leaders—the Mortgage Bankers Association (MBA), Fannie Mae, Freddie Mac, Ginnie Mae and servicing executives.

Their vision was simple—use modem-based electronic data interchange (EDI) to allow mortgage loan sellers, warehouse lenders, mortgage loan investors and servicers to "obtain, transfer and track interests in mortgages, essentially on a real-time basis," regardless of any internal proprietary systems that supported their business operations.

All three legs of the tri-party stool contribute to the accuracy and maintenance of the registry in addition to serving as checkpoints.

Up until then, liens were tracked by local land records offices, with varying and often antiquated systems. Though seldom recognized, the purpose of the land records was not to track mortgage ownership rights, but to provide public notice of liens to protect the lien holder.

While other aspects of the mortgage lending supply chain were being digitized, including the 1990s development of automated underwriting systems (AUS) and loan origination systems (LOS), the recordation of the mortgagee or agent for the mortgagee in local land records remained a manual process.

Well-intentioned staff at bustling offices struggled to manage the congestion caused by the growing volume of mortgage loans. Missing and erroneous assignments caused gaps in the chain of title, threatening the integrity of the lending process. The late 20th-century prevalence of secondary market transactions and advancement of management information systems pushed the industry to pursue a more efficient solution.

Process

Traditionally, the borrower executes two essential documents at closing. These two documents make up the mortgage loan. Although the legal distinction between them is fundamental, it is often overlooked in common parlance. The first document is the promissory note, which signifies the borrower's promise to repay the loan over a period of time under stated terms. Notes can technically exist without collateral, so the second document, the mortgage, secures the promissory note by placing a lien on the real property as security for the loan's repayment.

The note is typically endorsed "in blank" and delivered from the lender to the mortgage loan aggregator and/or securitization trust. The note is intended to be a fluid, negotiable instrument in trade where possession is sufficient to confer the right to enforce ownership interest.

The mortgage follows the note. That is to say that a transfer in the ownership of the promissory note also transfers with it the underlying secured obligation to pay.

Traditionally, when a loan was sold to another lender—for example, an aggregator—the mortgage was "assigned" to the purchaser and recorded in the purchaser's name. However, if the servicing remained with the seller, as was often the case, the mortgage usually continued to be recorded under the servicer's name.

The seller would then prepare a "recordable assignment in blank" and deliver it to the trust. Where MERS is the mortgagee of record, subsequent assignments of the mortgage no longer need to be recorded at the local recorders' offices because MERS holds the mortgage in trust on behalf of its member, who owns the note.

The land records have never been an authoritative source for who owns beneficial interests and servicing rights to mortgages. The assignment, which is usually recorded to protect the lien holder, is generally not required by the county, and has nothing to do with the sale of servicing rights. If the servicing rights changed hands, then the county land records were updated *if* the new servicer desired to receive service of process in order to fully perform under its servicing agreement with the investor. The advent of MERS enhanced this last step.

A predecessor to the current configuration of MERS and MERSCORP was officially created in 1995 as an industrywide utility to hold mortgage liens in an agency capacity on behalf of participants in the mortgage banking industry, and to track the changes in the ownership and servicing of any registered loan.

At closing, the lender and borrower make MERS the mortgagee of record, and all subsequent changes in the mortgage loan ownership and servicing rights of the loan are updated in the database provided the loan continues to be registered in the MERS System. Moreover, MERS was established as a part of a tri-party organization managed by the limited staff of MERSCORP, the lender participant and the founding agencies. Accordingly, all three legs of the tri-party stool contribute to the accuracy and maintenance of the registry in addition to serving as checkpoints.

The efficiencies realized by the registry provided incremental value to lenders that sold loans into the secondary market. Mortgage banking was a process that frequently required several assignments, and even before MERS, there was already an active attempt to minimize assignment costs and third-party fees. Lenders had already begun preparing mortgage assignments in blank to enable fluid transmissions, and attempted to immobilize mortgage notes at the original clearinghouse member custodian to avoid future file movement and recertification. These practices merely continued with the introduction of MERS.

'Vault' idea

Because the original WLBE system was closely modeled after the electronic stock and bond registration model implemented by the Depository Trust Company (DTC) a couple of decades earlier, some industry participants in the early 1990s suggested that loan documents, like physical stock and bond certificates, should also be stored in a vault. The idea of a central vault was one of many ideas circulated as the clearinghouse was being brainstormed, although it never became an official feature of the clearinghouse upon its official conception.

The vault idea was forgone presumably because loan document immobilization was already taking place. The Depository Trust and Clearing Corporation's (DTCC's) depository vaults, for instance, immobilized stock and bond certificates. As a result of electronic registrations and transfers, futures, options and bonds are now issued electronically.

But the vault idea did not totally disappear—the mortgage industry continued to pursue the vault concept with the advent of the electronic mortgage (eMortgage). Prior to conservatorship, both Fannie Mae and Freddie Mac pursued initiatives for the electronic storage of eMortgages originated and closed by their approved seller/servicers and signed electronically.

Legal structure

MERS was designed to operate in accordance with existing real property law and the Uniform Commercial Code (UCC). MERS acts as mortgagee in the land records in a nominee (agent) capacity for the originating lender and the lender's successors and assigns.

The MERS System exists so MERSCORP knows who to send the service of process to because, under the MERS process, the current servicer continues to handle the day-to-day servicing responsibilities as it did prior to the advent of MERS.

When the underlying mortgage loan indebtedness (in the form of the promissory note) was sold from one lender to the next, the purchasing lender's interest would continue to be secured because MERS held legal record title for the benefit of the lender. MERS' role as agent for the promissory note owner in the land records is supported by both agency and contract law.

As mentioned earlier, it is not generally necessary to record an assignment to demonstrate mortgage loan ownership or convey a security interest. The benefit of recordation is to ensure that interested parties are apprised of existing liens or other legal encumbrances. Assignments are recorded so that subsequent servicers receive service of process for legal actions affecting the property that is encumbered by the lien.

Because mortgagee-of-record status renders MERS responsible to different parties in the mortgage loan ownership chain, contract agreements are prudently crafted between MERS, MERSCORP and third parties to establish loan ownership and security interests that retain the integrity of the original documents and have legal force.

Legal challenges and victories

Up until the nation's foreclosure crisis emerged, MERS remained largely absent from the public eye. However, with the dawning of the Foreclosure-Gate crisis, the business model of MERS came under scrutiny.

The defects in servicer foreclosure procedures were admittedly serious, and included the robo-signing of affidavits and improper notarization, but investigations did not demonstrate that the vast majority of these foreclosures were otherwise invalid. Nevertheless, the legal right of MERS to commence foreclosure action came under fire in numerous states, where plaintiffs filed suits questioning MERS' authority to foreclose as an entity that was not the actual owner of the loan.

In October 2010, Washington, D.C. Attorney General Peter Nickles issued an enforcement statement declaring foreclosures may not be initiated against a District of Columbia homeowner unless the security interest of the current noteholder is also reflected in the local recorder's office.

As a relatively unknown entity with the power to foreclose, MERS and the MERS System became the focus of intense scrutiny. However, the past couple of years have unleashed a flood of cases in judicial and non-judicial foreclosure states that were adjudicated in MERS' favor.

- *Utah:* Two March 2011 rulings *(Wade v. Meridias Capital Inc., MERS et al;* and *Wareing v. Meridias Capital)* in Utah, a non-judicial foreclosure state, have affirmed MERS' ability to act as the beneficiary of the deed of trust and nominee of the lender and its successors and assigns. The judges confirmed that this authority is conferred when a borrower signs a deed of trust on which MERS is expressly appointed the beneficiary. As such, mortgage assignments by MERS are valid and its execution of foreclosure is legal. These two cases were a small number of the many court decisions and orders in Utah that have upheld MERS' ability to be the beneficiary on a deed of trust and which dismissed challenges to MERS' authority to foreclose or assign.
- *Wyoming:* A similar memorandum *(In re Martinez)* followed in March 2011 in Wyoming, where the authority of MERS relative to assigning a mortgage had likewise been contested. The argument failed because the borrower signed a mortgage at closing expressly authorizing MERS "to take any action required of the lender."
- *California:* Also in March 2011, a plaintiff filed a claim under the California False Claims Act (CFCA), asserting MERS has made false representations in order to circumvent payment of recording fees required to reflect security interests in real property. The suit *(Bates v. MERS)* was dismissed by the District Court for the Eastern District of California, which determined it was without jurisdiction over the plaintiff's action because the plaintiff was not an original source of the information as required under the CFCA.

Further rulings recognizing MERS as the beneficiary of the mortgage or deed of trust, similar to those found in Utah and Wyoming, have also been made in Oregon, New York, Massachusetts, Georgia, New Hampshire, California, Alabama, Nevada, Virginia, Rhode Island, Michigan and Kansas this year. As the mortgagee of record

and holder of the original note endorsed in blank, the cases support MERS' legal standing to initiate foreclosure proceedings.

Laurence E. Platt, a partner with K&L Gates LLP in Washington, D.C. with expertise in real estate finance who has worked on MERS issues over the years, acknowledges the significance of the rulings: "With favorable decisions in multiple states, it is clear that the basis for which MERS was founded is valid, and that MERS has the affirmation of the overwhelming majority of courts to act as the lender's nominee as provided in the mortgage documents," he says.

"MERS was created to enable efficiencies in a paper-based business. MERS continues to achieve its objectives, and if an entity like MERS did not exist today, it would have to be created to enable the efficient operation of the capital markets," Platt says.

Although recent litigation has upheld the permissibility of MERS to commence foreclosure action, the practice is slated to come to an end where it has not already ended.

Corporate governance challenges

While MERS' legal standing has been vindicated by state and district courts, its corporate governance structure recently came under the review of federal regulators. The *Interagency Review of Foreclosure Policies and Practices* and consent order for MERS were posted to the Federal Reserve Board's website on April 13.

In testimony before the Senate Committee on Banking, Housing and Urban Affairs on Feb. 17, 2011, Acting Comptroller of the Currency John Walsh explained to the Congress that an interagency examination of MERS' operations, procedures and controls had been under way.

The recent consent order between MERS and federal regulators follows several organizational changes already taking place within MERSCORP. On Jan. 22, 2011, R.K. Arnold, president and chief executive officer of MERS and MERSCORP, resigned. MERSCORP issued a statement on its website acknowledging the resignation and announcing an interim replacement. "MERSCORP Inc. . . . today announced the retirement of President and [Chief Executive Officer] R.K. Arnold. Arnold joined the company at its inception and has been instrumental in the development of the MERS System, a registry of ownership and other mortgage rights for more than half of all outstanding residential mortgages in the United States. . . . Arnold is succeeded on an interim basis by financial services industry veteran Paul Bognanno," the company announced. An announcement on a permanent successor has yet to be made.

While Walsh made general remarks on the review of MERS and MERSCORP in his testimony, he did not mention Arnold's resignation: "[T]he agencies [OCC, the Federal Reserve Board (FRB), FDIC, OTS] conducted interagency examinations of MERSCORP and its wholly owned subsidiary, Mortgage Electronic Registration Systems Inc. . . . which provide[s] significant services to support mortgage servicing and foreclosure processing across the industry. The primary objective of the examinations was to evaluate the adequacy of controls and governance over bank foreclosure processes, including compliance with applicable federal and state law. Examiners also . . . assessed foreclosure operating procedures and controls, interviewed bank staff involved in the preparation of foreclosure documents, and reviewed approximately 2,800 borrower foreclosure cases in various stages of foreclosure. Examiners focused on foreclosure policies and procedures, organizational structure and staffing, vendor management including use of third parties, including foreclosure attorneys, quality control and audits, accuracy and appropriateness of foreclosure filings, and loan document control, endorsement and assignment."

Many of the lapses in safety and soundness cited in the final interagency review were ascribed to servicer performance in the oversight and quality control of MERS. But the agencies also identified non-servicer-related deficiencies that presented "financial, operational, compliance, legal and reputational risks to MERSCORP and MERS, and to the participating members." When the consent order was issued, it was publicly announced that MERSCORP and MERS had already begun implementing remedial procedures.

Moving forward, MERSCORP and MERS have committed to the following actions:

- Forming a compliance committee to monitor compliance with the terms of the consent order;
- Formulating an action plan with a complete description of the actions necessary to comply with the order;
- Engaging an independent third party to assess board, management, officer and staffing needs in order to operate safely and soundly;
- Formulating a communications plan with members to establish a standard protocol for dealing with significant legal matters;
- Formulating a governance plan to strengthen processes as they relate to authorizing MERS certifying officers; and
- Obtaining an independent third party to review the effective operations of the eRegistry system of recording electronic notes.

Financial sanctions against MERSCORP and MERS were not imposed by regulators in the consent order.

MERS: 'No more foreclosures in the MERS name'

Before the consent order was issued, a number of policy changes were announced by MERSCORP. The most notable was published in Policy Bulletin 2011-2 on March 8, 2011, announcing the revocation of member authority to commence foreclosures in the MERS name.

According to the Policy Bulletin, the policy would become effective Aug. 1, 2011, upon approval by the board of directors of MERS and MERSCORP: "The authority to conduct foreclosures in the name of MERS granted to a member's certifying officers under the member's MERS Corporate Resolution is revoked. Effective Aug. 1, 2011, the member shall be sanctioned $10,000.00 per violation for commencing a foreclosure in the name of MERS. The member will automatically be in violation of this rule and subject to the enforcement of the fine when the first legal action is taken in MERS name."

Although recent litigation has upheld the permissibility of MERS to commence foreclosure action, the practice is slated to come to an end where it has not already ended. (Where the practice ends depends on servicer policy and/or whether the securities are Fannie and Freddie securitizations, not on market/jurisdiction.)

Tri-party management allows swift policy change

Concurrent with discussions over Policy Bulletin 2011-2, several major servicers, including Charlotte, North Carolina–based Bank of America, New York–based JPMorgan Chase and San Francisco–based Wells Fargo & Co. implemented internal policy changes requiring the de-registration of loans that were in the MERS name before initiating foreclosure. The purpose of the change was to provide clarity to the defaulted mortgagor and minimize legal and compliance risk to the servicer.

Furthermore, any Fannie Mae and Freddie Mac servicers that did not implement the policy on their own are now required to do so. That change was implemented via the following policy directives:

- *Freddie Mac Bulletin 2011-5, March 23, 2011:* Eliminated the option of Freddie Mac servicers to foreclose in the MERS name. Going forward, the securitization must be assigned from MERS back to the servicer by means of recordation where required by law.
- *Fannie Mae Announcement 2010-05, March 30, 2010:* MERS may not be named as the plaintiff of any mortgage loan owned or securitized by Fannie Mae. The servicer must prepare an assignment via recordation to transfer the security interest from MERS to the servicer. Effective May 1, 2010.

The politics of MERS in the housing crisis

Even as MERS turns the tide by prevailing in state courthouses around the country, the challenges the mortgage industry faces post-boom as a result of the widespread destruction of home values remains a political nightmare.

In addition to the agency consent order, a 50-state attorneys general (AG) task force contends it is negotiating a 27-point draft servicer settlement (or term sheet) with a handful of megaservicers. Conspicuously present in that draft agreement is language stating that the subject of MERS is held for separate review. It appears that the agency consent order has addressed the AG task force reference to MERS and its organizational structure.

The mention of MERS in the AG draft agreement signifies that its utilization may become a matter that is settled between servicers and regulators, rather than litigated or legislated. In light of this possibility, in my view, the probability that MERS will end up a political casualty may be lowered.

The ongoing need for an electronic registry

By serving as the mortgagee in the county land records on behalf of its members, MERS has become a critical component of housing finance. Since its inception, MERS has enabled fluent commerce in the housing finance markets, much like the advent of electronic registration in lieu of stock certificates enabled fluent commerce in an age of trading stocks online.

The soundness of a borrower's property rights is far from compromised by the frugality of paperless business; instead, it is improved, as the enormous volume of mortgages issued and transferred could not be sustained by congesting the land records with reassignments.

In fact, the services of MERSCORP have not been exploited to their full, value-adding potential. If the traditional, paper-based format of the promissory note and the mortgage document were produced electronically (versus manually) at closing and registered within a single system like MERSCORP's MERS eRegistry, it would be virtually impossible to create duplicate notes.

The incidence of fraud would be reduced by the instant visibility conferred by a system like the MERS eRegistry. The legal underpinnings necessary to realize such a system have been in place since 2000, when the Clinton administration passed the Electronic Signatures in Global and National Commerce Act (E-SIGN), recognizing the equivalence of authenticity and enforceability between electronic and paper signatures.

In addition to federal law, 47 states and the District of Columbia have enacted Uniform Electronic Transactions Act (UETA) laws in their own statutes, acknowledging the validity of electronic signatures. The three remaining states—Illinois, New York and Washington—have adopted separate laws recognizing the validity of digital signatures as well.

Chris Christensen, an attorney with PeirsonPatterson LLP law firm in Dallas, has closely followed the foreclosure crisis. Christensen says, "The MERS® eRegistry is the key to solving the lost document problem. As a critical piece of eCommerce infrastructure, the eRegistry is also key to solving the industry's data problem. These two problems have largely contributed to the housing crisis. The good news is that they are not permanent problems if the industry acts now to implement the appropriate solutions. The MERS eRegistry is part of the solution and not the problem."

Christensen adds, "Had the industry focused on understanding the MERS value proposition with its electronic registry, we could have avoided the lost-document and data-based issues at the heart of the foreclosure crisis. But hindsight is always 20/20." MB

Allen H. Jones is chief operating officer of RiskSpan Inc., a mortgage valuation technology and advisory consulting services firm based in New York and Washington, D.C. He can be reached at ajones@riskspan.com.

www.researchsolutions.com
1.866.WE.FIND.IT

Please note the following:

- [x] Some pages in this article were advertisements or were blank and therefore have not been included.
  Pages: 37

- [ ] This is the best copy available.

- [ ] The article has a very tight binding.

- [ ] The article provided has a citation slightly different from the original request.

- [ ] There was no color in this article.

- [ ]

APPENDIX A.5

Practising Law Institute
Friedman on Contracts and Conveyances of Real Property

Milton R. Friedman

Copyright (c) 2011 by the Practising Law Institute

Current through Release 11, May 2011

Chapter 6: Assignments of Contracts of Sale
§ 6:1 Buyers' Assignments

***6-10** § 6:1.5 Nominees

As heretofore mentioned, it is familiar practice in real estate transactions to use a nominee (sometimes called a "dummy," "straw," or "straw man") as the buyer instead of the real party in interest. [FN43] ***6-11** Purposes for using a nominee, many of which are legitimate, include: to sign a contract of sale; to take title to the property; to execute mortgage instruments; to avoid claims of creditors; to avoid publicity, particularly in assembling adjoining properties; to facilitate a resale where the owner is married or the property is in multiple ownership; to place property in the hands of a qualified manager; and to give security to one advancing money for the purchase. [FN44] When a corporation is arranging to buy land and will be the beneficial owner, placing title in a nominee avoids questions of power, resolutions, compliance with laws, and receipts for corporate taxes. Where the owner is under a legal disability (a minor, alien, trustee, church corporation, unlicensed foreign corporation) these facts can be kept off the record.

There is nothing fraudulent in using a nominee for the purchase of real estate if no misrepresentations are made. [FN45] Nor is it material that the nominee conceals the fact that he is acting for another. [FN46] But if the ***6-12** nominee misrepresents the identity of his principal, with knowledge that the seller would not negotiate if he were in possession of the facts, the seller may, on learning the facts, refuse to convey or rescind a conveyance. [FN47] And a seller may refuse to convey on discovering the real party in interest is the seller's broker and the party named in the contract is merely his nominee. [FN48] Proof of any such situation may be very difficult to establish. [FN49] A right of rescission that might be available in the circumstances may be lost by laches. [FN50]

These rules mean that the seller cannot assume that he is dealing with, and contracting with, the actual buyer. If the seller cares about the true identity of the buyer, the seller must bargain for express representations in the contract, and restrict assignments of the contract. But even with these measures, there is nothing legally or practically that the seller can do to prevent a post-closing conveyance by the buyer to another person. If the seller's main concern is not the actual identity of the buyer, but rather the possibility that the property ***6-13** may be put to some undesired use, the seller's remedy is to impose a restrictive covenant. [FN51]

Use of a nominee does not normally alter the rights of third parties under preexisting contracts. A broker normally earns her commission if she introduces the principal to the seller, notwithstanding the fact that the principal thereafter selects a nominee to enter into the contract with the seller. [FN52]

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Where a purchaser under a contract of sale is a nonexistent corporation, the seller may withdraw its acceptance prior to the purchaser's incorporation. [FN53]

A nominee who has executed a contract of sale as purchaser may enforce the contract in his own name in a suit for specific performance and may maintain an action for recovery of the down payment in case of defective title or, presumably, for damages. [FN54] But there is no legal impediment to the nominee's assigning his rights under the contract of sale to his principal.

If the contract of sale is under seal and is executed by a nominee as purchaser, the principal is not liable wherever the common-law rule obtains, that is, that a principal who is not mentioned in an instrument made by his agent under seal is not liable thereunder. [FN55] Accordingly, in these circumstances the principal is not liable to the seller in an action for the purchase price or for specific performance. [FN56] In these cases the seller's real protection is in obtaining a down payment large enough to protect him against a default on the buyer's part.

Whenever a purchase involves mortgage financing, use of a nominee complicates the deal. One consideration is personal liability on ***6-14** mortgage debt. The real buyers may seek to avoid personal liability on existing or new mortgage obligations. With respect to an existing mortgage, there may be a need for the buyer to assume the mortgage, rather than take subject to the mortgage debt. If so, an individual or corporate nominee takes title at the closing and assumes the debt. With respect to a new purchase money mortgage, the nominee takes title and executes the mortgage instruments. In either case, the nominee will promptly convey to the real parties in interest, subject to the mortgage. In this connection, it is important that: (1) the nominee be solvent and free of judgments [FN57] (in those states in which judgments are liens upon realty), so that the title will not be adversely affected by the momentary ownership of the nominee; and (2) the contract permit such a transaction.

Today nominees are not frequently used for the purpose of avoiding personal liability on assumed or new mortgages. In the past the practice was common, but it is seldom needed due to the widespread use of nonrecourse mortgages and comparable instruments in commercial financing transactions since the 1960s. Moreover, when mortgagees require personal liability, the mortgage usually contains a "due on sale" clauses, which the mortgagee will use to prevent a conveyance from a nominee to the true owners.

When a nominee is used, the insulation of the principal from liability on the mortgage debt is based, in part, on the rule of law that a conveyance subject to a mortgage (as distinguished from an assumption thereof) imposes no personal liability, under the mortgage or the debt thereby secured, on the grantee. It is also based on two rules relating to instruments executed by an agent (the nominee in this situation) and to which the principal is not a party. [FN58] The principal is not liable, as indicated above, if the instrument is under seal, nor if the instrument is negotiable. [FN59] The use of nominees for ***6-15** this purpose is recognized as legitimate unless the mortgagee has been led to believe the real party in interest is personally liable. [FN60] And an owner, who conveys to or shunts title through a nominee, in order to have the latter execute the mortgage instrument, is not liable on the mortgage debt or for a deficiency judgment. [FN61] Nor may the mortgagee, in most cases, succeed in reaching the principal, on the theory of being subrogated to the claim of an agent (the nominee) against his principal for exoneration from liability or reimbursement for his loss, it being understood that

> [a] "straw" is a conduit, usually an impecunious person who cannot respond in damages to anyone and who ordinarily, for this reason, does not expect to be indemnified in the event he suffers a loss. Nor usually does a person who uses a straw in this type of transaction expect in any way to be liable. . . . This is usually understood by all the parties concerned. [FN62]

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The nominee is almost invariably irresponsible financially. One of the few cases allowing subrogation against the principal is based largely on the fact that the nominee was a person with substantial income. The court refused to believe the parties intended this nominee to assume a liability of over $100,000 in return for a $25 fee. [FN63] And in a Pennsylvania case a nominee, who defied precedent by subsequently acquiring means and paid a deficiency judgment recovered against him, recovered judgment against the principal for reimbursement. [FN64]

***6-16** In most cases title is placed in the name of the nominee just long enough for signing purposes and then reconveyed the same day. [FN65] In several cases, however, title to groups of property was left in the name of the nominee, who had signed mortgages on these properties. In one such case the nominee, when faced with a deficiency judgment, conveyed twenty-six parcels of real estate, in which she had no beneficial interest, to her principal. An effort to set aside this conveyance as fraudulent was defeated on the ground that the knowledge of the purpose and position of the nominee in the circumstances negated the existence of any fraud. [FN66] But in two New York cases, which were virtually identical except that corporate nominees were involved, the reconveyances to the principal were held fraudulent. [FN67] With the advantages of hindsight, there seems little to commend any practice of permitting a nominee who is liable on mortgage debts to retain title to parcels of real estate.

Changes in the effect of a sealed instrument prompt a reexamination of the use of such instruments in connection with nominee transactions, insofar as their purpose is to insulate the principal from liability. By statute in New York the presence of a seal has lost all legal effect upon the instrument. [FN68] About half the states now have statutes purporting to abolish private seals and making them inoperative when used. [FN69] In other jurisdictions courts have diminished the effect of the seal. [FN70] Where this is true, a nominee's execution of a ***6-17** sealed instrument no longer insulates the principal. [FN71] Even execution of a negotiable mortgage note may be ineffective for this purpose if the accompanying mortgage executed by the nominee contains a covenant to pay the mortgage debt, because this covenant makes the mortgage a bond as well as a mortgage. As a result of these changes in the effect of sealed instruments, cautious principals often seek to include in all instruments executed by nominees--contracts of sale and mortgage notes and bonds, for instance--a statement to the effect that the mortgagee or other creditor recognizes the other party to the instrument as a principal and will not look to the liability of any third person. It is also necessary to obtain a general release, from the nominee to the principal, in order to cut off any claim of the nominee for reimbursement and to cut off, as well, any right of subrogation in or through the nominee.

[FN43]. "The use of a nominee in real estate transactions, and as mortgagee in a recorded mortgage, has long been sanctioned as a legitimate practice [and] is likewise legitimate under the Uniform Commercial Code." *In re* Cushman Bakery, 526 F.2d 23, 30 (1st Cir. 1975), *cert. denied*, 425 U.S. 937 (1976).

[FN44]. *See* 5 A. Scott, Trusts § 440 (4d ed. 1989). Gill, *Straw Man in Missouri*, 14 Mo. B.J. 98 (1943), adds more reasons, including:• to keep information from creditors and tax collectors;• to convey real property at a time of appeal from judgments;• to have warranties given by straw man (provided, of course, the purchaser does not question the solvency of the warrantor);• to make transfers without the knowledge or consent of existing or former wives, thereby avoiding claims of dower or homestead;• to avoid fines for failure to comply with tenement house laws, etc.;• to avoid personal liability on mortgage obligations;• to divide income or profits to lower tax brackets;• to avoid the liens of mortgages with after-acquired mortgage

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

clauses;• to deal with property as if the owner were a broker, and thereby earn a commission which would be unavailable to a principal, or as an agent, and refer all offers to his "principal," to negotiate; higher rent or purchase price;• to carry multiple properties in different names so that a judgment against one will not affect the others;• to use a nominee as the equivalent of an attorney-in-fact when the principal is out of the country;• to handle property with multiple ownership, with respect to interparty transactions or sales and mortgages with greater ease than if all the interests appeared of record;• to avoid administration proceedings in probate courts;• to permit an administrator, executor, guardian, or donee of a power to buy in on his own sale, attempting thus to avoid all attack on the sale;• to avoid the appearance of usury by having a mortgagee purchase the mortgage from a straw lender;• to purchase at a judicial sale, on behalf of a co-tenant in an effort to cut out another co-tenant or to cut out a life tenant.

[FN45]. Benton v. Alcazar Hotel Co., 180 S.W.2d 33 (Mo. 1944).

[FN46]. Roy Annett, Inc. v. Kerezsy, 57 N.W.2d 483 (Mich. 1953); Hirsch v. Silberstein, 227 A.2d 638 (Pa. 1967). *Cf.* Cole v. Hunter Tract Improvement Co., 112 P. 368 (Wash. 1910).

[FN47]. Brett v. Cooney, 53 A. 729 (Conn. 1902); Wloczewski v. Kozlowski, 70 N.E.2d 560 (Ill. 1946), noted in 32 IOWA L. REV. 790 (1947) (overruled in Gould v. Stelter, 152 N.E.2d 869 (Ill. 1958), insofar as *Wloczewski* was based on a supposed want of mutuality, but not with respect to point cited in text); Gray v. Baker, 485 So. 2d 306 (Miss. 1986) (for any reason other than one legally impermissible); Siess v. Anderson, 139 S.W. 1178 (Mo. Ct. App. 1911); *see generally* Walker v. Galt, 171 F.2d 613 (5th Cir. 1948) (rescinding completed conveyance, subject to grantor's payment for improvements made by grantee, measured by the property's increased value to grantor attributable to the improvements; White Tower Mgmt. Corp. v. Taglino, 19 N.E.2d 700 (Mass. 1939) (denying specific performance). Restatement (Second) of Agency § 304 (1958). *But see* Hirsch v. Silberstein, 227 A.2d 638 (Pa. 1967).

[FN48]. Larner-Diener Realty Co. v. Fredman, 266 S.W.2d 689 (Mo. 1954) (despite agreement that seller not liable for brokerage, and purchase price to be net); Carluccio v. 607 Hudson St. Holding Co., 57 A.2d 452 (N.J. 1948) (contract fraudulently obtained when broker presented seller with contract from "straw persons," who assigned to broker's colleague prior to closing; broker misrepresented address of straws and concealed assignment until eve of closing). *Cf.* Huber v. Gershman, 286 S.W.2d 558 (Mo. Ct. App. 1955). But where a contract of sale made the purchaser's obligation to buy parcel *A* conditional upon the broker's selling purchaser's property, parcel *B*, within thirty days for $10,500 net, purchaser could not validly object to the broker's purchase of parcel *B* on the terms specified. Surratt v. Cohn, 134 A.2d 643 (D.C. 1957) (purchase liable on note given as down payment on parcel *A*).

[FN49]. *Compare* Major v. Christian County Livestock Mkt., 300 S.W.2d 246 (Ky. 1957), where purchaser represented his purpose was to erect a home despite a resale within a month to a corporation of which he was an officer and stockholder for a livestock market, rescission was denied on ground of an honest change of mind.

[FN50]. Keyerleber v. Euclid Congregation of Jehovah's Witnesses, 103 Ohio App. 423, 143 N.E.2d 313 (1957).

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

[FN51]. *See supra* section 5:2. Annot., *Purchaser's Misrepresentations as to Intended Use of Real Property as Ground for Seller's Equitable Relief from Contract and Deed*, 35 A.L.R.3d 1369 (1971).

[FN52]. Helmsley-Spear, Inc. v. New York, 687 N.Y.S.2d 353 (App. Div. 1st Dep't 1999) (buyer selected different nominee than the one originally anticipated; seller owes commission).

[FN53]. Macy Corp. v. Ramey, 144 N.E.2d 698 (Ohio 1957).

[FN54]. Gould v. Stelter, 152 N.E.2d 869 (Ill. 1958); Roy Annett, Inc. v. Kerezsy, 57 N.W.2d 483 (Mich. 1953); Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953). *But see* Houtz v. Hellman, 128 S.W. 1001 (Mo. 1910), where the plaintiff-nominee sought specific performance of a contract of sale he had never signed. The principal or a third person had signed the nominee's name. Recovery was denied on the ground the defendant was entitled to have plaintiff bound at the outset and not merely vested with an option.

[FN55]. Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953).

[FN56]. *In re* Childs Co., 163 F.2d 379 (2d Cir. 1947); Shawsheen Manor Corp. v. Colantino, 110 N.E.2d 380 (Mass. 1953); Crowley v. Lewis, 146 N.E. 374 (N.Y. 1925); Briggs v. Partridge, 64 N.Y. 357 (1876); Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953).

[FN57]. But in United Loan & Inv. Co. v. Nunez, 282 S.W.2d 595 (Ark. 1955), where husband and wife, owners of realty as tenants by the entirety, conveyed to a straw for immediate conveyance to the wife, a judgment against the straw was held without effect on the property. This was on the ground that the judgment attached only to the straw's interest, which was at all times subject to an obligation to reconvey.

[FN58]. *See generally supra* § 6:1.2.

[FN59]. N.Y. Life Ins. Co. v. Martindale, 88 P. 559 (Kan. 1907); *see* Naas v. Peters, 58 N.E.2d 530 (Ill. 1944); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941); Mfrs. & Traders Bank v. Love, 43 N.Y.S. 812 (App. Div. 4th Dep't 1897). The principal may, however, be subject to a quasi-contractual liability where he has received the benefit of the contract. 2 F. Mechem, Agency § 1736 (2d ed. 1914). The most recent version of the U.C.C. rejects the traditional rule that an undisclosed principal is not liable on a negotiable instrument. U.C.C. § 3-402(a) (2005 revision).

[FN60]. Greenwald v. Marcus, 123 N.E.2d 139 (Ill. 1954); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941); Nat'l Ref. Co. v. Cont'l Dev. Corp., 189 S.W.2d 551 (Mo. 1945); *accord In re* Sickle, 138 A.2d 813 (D.C. 1958); Riskin v. Green, 138 A.2d 813 (D.C. 1958); *In re* Childs Co., 163 F.2d 379, 382 (2d Cir. 1947).

[FN61]. Underwood v. Patrick, 94 F. 468 (8th Cir. 1899); Barkhausen v. Cont'l Ill. Nat'l Bank & Trust Co., 120 N.E.2d 649 (Ill.), *cert. denied*, 348 U.S. 897 (1954); State *ex rel.* Mesker v. Reynolds, 245 S.W. 1065 (Mo.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

1922).

[FN62]. *In re* Sickle, 138 A.2d 813, 814 (D.C. 1958); *accord* Deitrick v. Ulin, 33 F. Supp. 1001, 1004 (D. Mass. 1940); Riskin v. Green, 138 A.2d 813 (D.C. 1958); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941).

[FN63]. Halsey v. Brown, 177 Misc. 415 (N.Y. County Ct. 1941).

[FN64]. Aronson v. Heymann, 56 Pa. Super. 501 (1914). The opinion cites the Pennsylvania rule, followed in a minority of the states, that whereas a conveyance subject to a mortgage does not make the grantee personally liable to the mortgagee on the mortgage debt, it makes the grantee an indemnitor of the mortgagor against liability. But it will be noted that Halsey v. Brown, 177 Misc. 415 (N.Y. County Ct. 1941), reaches substantially the same result in New York, which follows the majority rule, to the effect that a conveyance subject to a mortgage imposes no liability, either direct or indirect, on the grantee.

[FN65]. A Pennsylvania statute makes the lien of corporate taxes of a corporate owner paramount to a mortgage on the corporation's property, unless the mortgage was created by a predecessor in title to the corporation. 72 Pa. Cons. Stat. § 1401. It was held that a nominee to whom the premises had been conveyed to make a mortgage, and who promptly reconveyed, was such predecessor and that a purchaser at foreclosure took free of a corporate tax levied after there conveyance. Commonwealth v. Hoffman-Henon Co., 114 A.2d 92 (Pa. 1955).

[FN66]. Nat'l Ref. Co. v. Cont'l Dev. Corp., 189 S.W.2d 551 (Mo. 1945).

[FN67]. Natelson v. A.B.L. Holding Co., 183 N.E. 373 (N.Y. 1932); Fraw Realty Co. v. Natanson, 185 N.E. 679 (N.Y. 1933). *Cf.* Hegstad v. Wysieki, 165 N.Y.S. 898 (App. Div. 2d Dep't 1917).

[FN68]. N.Y. Gen. Constr. Law § 44-a ("Except as otherwise expressly provided by statute, the presence or absence of a seal upon a written instrument executed after [Aug. 31, 1941] shall be without legal effect.").

[FN69]. The statutes are collected in 1A A. Corbin, Contracts § 254 (1963); 1 S. Williston, Contracts § 219A (3d ed. 1957); *see* Md. Code Ann., Real Prop. § 4-101B (1990).

[FN70]. Massachusetts discarded the common-law sealed doctrine with respect to instruments executed on behalf of an undisclosed principal in Nalbandian v. Hanson Rest. & Lounge, Inc., 338 N.E.2d 335 (Mass. 1975) (buyer's action for specific performance against corporation that was undisclosed principal; named seller was individual who was president of corporation).

[FN71]. Pittsburgh Terminal Coal Corp. v. Williams, 70 F.2d 65 (3d Cir. 1934).

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

END OF DOCUMENT

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

APPENDIX A.6

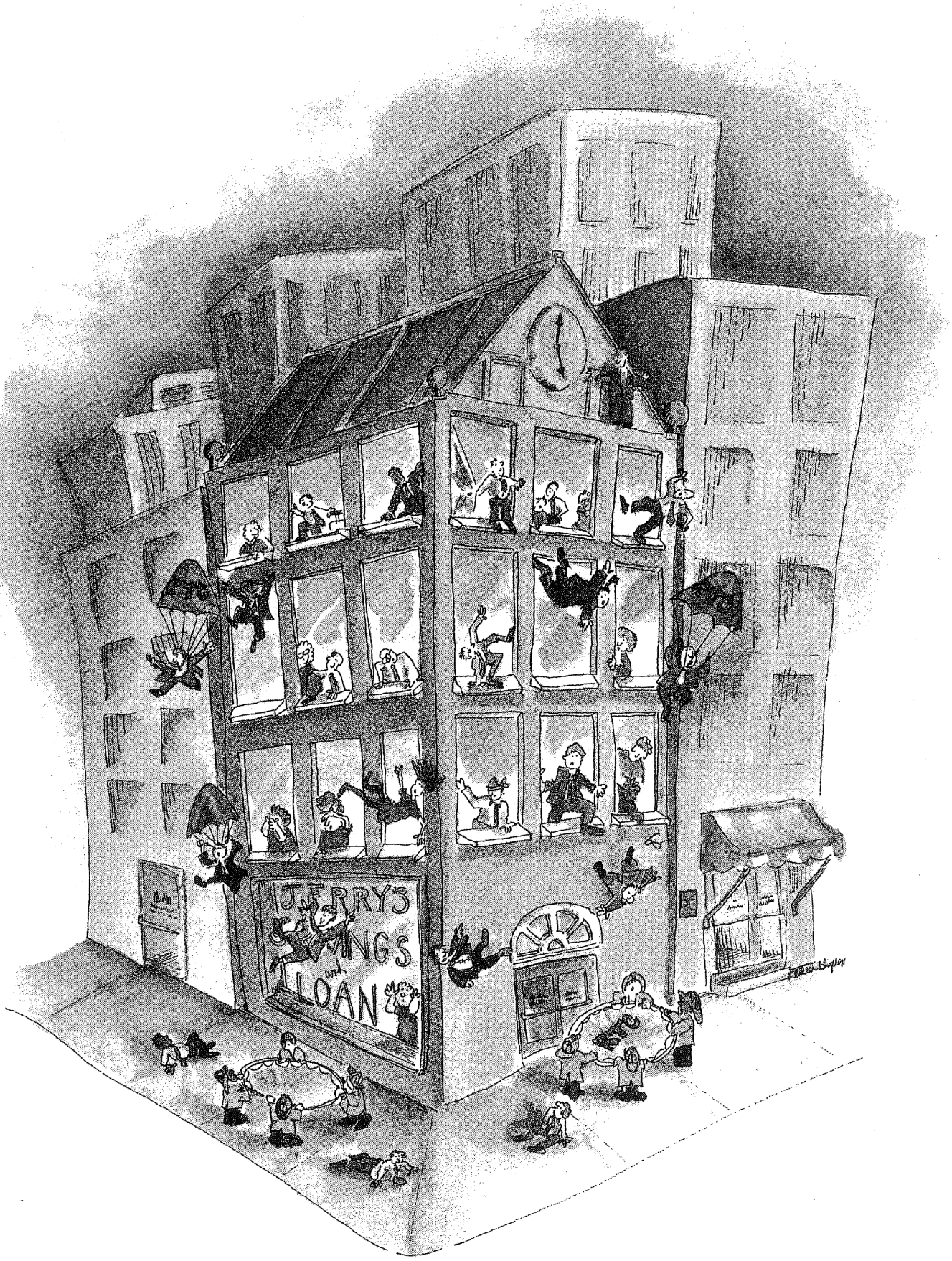
THE EFFECT OF THE S&L BAILOUT ON TITLE TO REAL PROPERTY

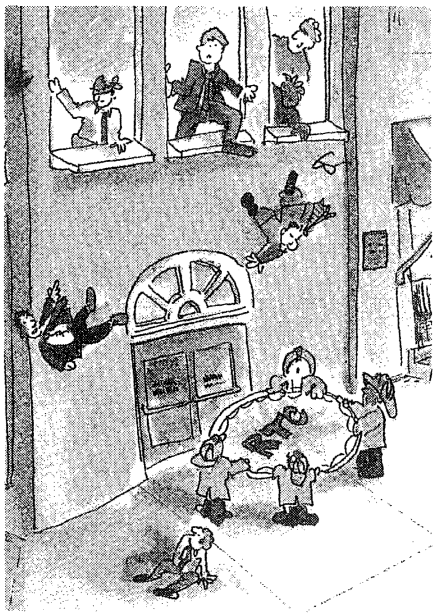
By Jeffrey J. Miller

"IN MOST STATES, NO DOCUMENT IS RECORDED AMONG THE PUBLIC RECORDS TO SHOW THE TRANSFER OF THE REAL PROPERTY ASSETS FROM THE OLD S&L TO THE NEW S&L. THE LACK OF RECORDATION CREATES A GAP IN THE CHAIN OF TITLE TO THE REAL PROPERTY."

Faced with the failure of over 500 savings and loan institutions (S&Ls) throughout the United States within recent years and the possibility of up to 500 additional failures, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Among other things, FIRREA established various new federal agencies, including the Resolution Trust Corporation (RTC), to resolve the S&L crisis and help contain, to the extent possible, the losses resulting from the mounting S&L failures. Because of deregulation in the S&L industry in the late 1970s and early 1980s, many S&Ls

Illustration by Eileen Blyth


JERRY'S
SAVINGS
and
LOAN



invested heavily in real estate loans, joint ventures and direct investments. The resulting S&L failures have had a wide impact on real property in the United States.

Although only about 10% of the assets held by S&Ls currently in receivership are real estate assets, real estate makes up a large portion of the "bad" assets of the S&Ls. These non-performing assets eventually will be transferred to the RTC for disposition. Most of the "good" assets of the failed S&Ls—the deposits, the branches and single-family residential mortgages—will be sold to the purchasers of the failed institutions, primarily banks. The percentage of real estate assets owned by the failed S&Ls ultimately will increase as the RTC completes foreclosures on many non-performing loans secured by real estate.

As the federal government, through the Federal Deposit Insurance Corporation (FDIC) and the RTC, works to resolve the current S&L crisis, it is confronted with taking over and managing huge deposit and loan portfolios of insolvent S&Ls as well as taking over and managing a wide variety of real estate assets that are owned by the S&Ls through their direct investments, foreclosure or loan workouts. The management and sale of those assets by the FDIC and the RTC has and will continue to have a significant effect on those assets. In addition, the action and policies of the federal agencies authorized to deal with the S&L crisis will have an impact on the future owners and developers of those assets, the states and municipalities within which those assets are situated, and real estate-related industries, especially the title insurance industry.

A Typical Takeover

The "pass-through receivership" is the primary mechanism used by the FDIC to manage a failed S&L and eventually dispose of its assets and resolve all of its liabilities. The pass-through receivership is created when the director of the Office of Thrift Supervision (OTS) decides that a particular S&L has substantially insufficient capital or inadequate liquid assets to pay its debts or obligations as they become due and, as a result, adopts an order appointing the RTC as receiver of the S&L. A newly chartered federal savings and loan association is then created by application to the OTS. The insolvent S&L, through the RTC as its receiver (the Old S&L), and the newly-created S&L (the New S&L) enter into a purchase and assumption agreement by which all or substantially all assets and liabilities of the Old S&L are transferred to the New S&L. The RTC is then appointed conservator of the New S&L, which continues the business of the Old S&L under the RTC's direction. The FDIC subsequently assumes the performance of the responsibilities of the RTC in its dual role as the receiver of the Old S&L and the conservator of the New S&L.

Under 12 U.S.C. Section 1821(d)(2)(A), the RTC, upon its appointment as receiver, succeeds by "operation of law" to all rights, titles, powers and privileges of the Old S&L, including all of its assets. Thus, the RTC, as receiver of the Old S&L, acquires title to all real estate owned by the Old S&L without further action and despite the conveyancing requirements of the particular jurisdiction within which those real property assets are located.

The New S&L thereafter acquires those assets by execution of the purchase and assumption agreement by the RTC, as receiver of the Old S&L, and by the RTC, as conservator of the New S&L. The purchase and assumption agreement may or may not transfer all assets and liabilities of the Old S&L to the New S&L.

RTC Powers as Receiver or Conservator

As conservator, the RTC generally has the power and authority to operate or dispose of a failed S&L as a going concern. As receiver, it has the power to liquidate and wind up the affairs of the institution. FIRREA grants to the RTC certain specific rights and powers as conservator or receiver of a failed S&L to assist the RTC in returning the S&L to a safe and solvent condition while preserving and conserving its assets and property. Set forth below are those powers and protections afforded the RTC, as conservator or receiver, that directly or indirectly affect real property:

- **Repudiation of Contracts and Leases.** Federal law provides that the RTC, as conservator or receiver of the Old S&L, can, within a reasonable period after its appointment, repudiate or disaffirm contracts entered into by the Old S&L before the receivership. 12 U.S.C. Section 1821(e). To repudiate a contract, the RTC must decide that the contract is burdensome and that its repudiation will promote the orderly administration of the affairs of the Old S&L. The RTC also must compensate the affected parties to a repudiated contract for their actual and direct compensatory damages that result from the repudiation. The RTC is authorized to repudiate all contracts, including real estate contracts for sale, leases and service contracts.

• **Prohibition Against Attachment or Execution of Liens.** Another federal law, 12 U.S.C. Section 1821(d)(13)(C), provides that no court may allow an attachment of or the execution on any asset in the possession of the RTC in its capacity as receiver. Thus, judgment liens, mechanics' and materialman's liens, assessment liens and other liens may not be enforced against any real property owned by the Old S&L while those assets are held by the RTC as receiver. Similarly, 12 U.S.C. Section 1825(b) states that no property of the RTC shall be subject to levy, attachment, garnishment, foreclosure or sale without the consent of the RTC, nor shall any involuntary lien attach to the property of the RTC when the RTC is acting as receiver. The RTC in its capacity as conservator is not given the same protections. The identity of the legal title holder to the property thus becomes important in evaluating the status of title to property being conveyed out of a pass-through receivership.

• **Tax-Exempt Status.** Section 1825(b) exempts the RTC and all of its income and property from all state and local taxes, except for ad valorem real property taxes. The RTC, however, is not liable for any penalties or fines resulting from any failure to pay real or personal property taxes. Many state laws also exempt federally owned property from all taxation. Therefore, the tax liability of the RTC appears to be greatly limited.

RTC's present policy, however, is to pay all taxes but not to pay any interest or penalties that have accrued before the date the RTC takes title to the property as receiver. As of the date the RTC takes title, all penalties and interest are stayed from accruing.

Section 1825(b) does not exempt the RTC from payment of taxes where its obligation is based on contract. For example, where the failed S&L is a tenant of real property is under a lease providing that the tenant reimburse the landlord for taxes, including rental taxes, the RTC will be responsible for this payment under its contractual obligations. The RTC is likewise responsible for taxes where it obtains services from a utility provider who passes the obligation to pay transaction privilege taxes to the user.

• **Transfer of Assets Without Consent or Approval.** Section 1821(d)(2)(G)(i)(II) provides that the RTC may, as conservator or receiver, transfer any asset of the Old S&L without any approval, assignment or consent for the transfer (except for any necessary approval of the appropriate federal banking agencies). Thus, despite any contractual or deed restriction preventing the transfer of any of these assets without certain consents or approvals, the RTC, in its capacity as receiver or conservator of the Old S&L, can freely transfer these assets to the New S&L and, eventually, to a purchaser. Although a conveyance or transfer may be made without approval, absent such approval, the RTC may create a claim for damages by the party whose approval right was superseded.

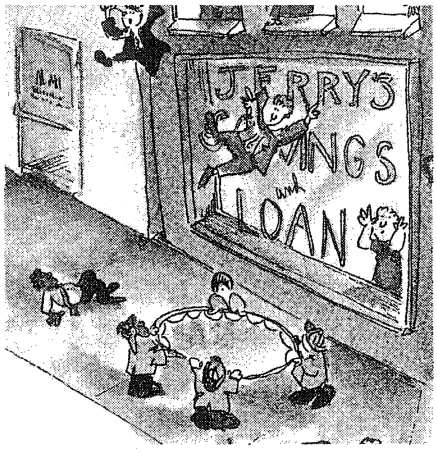
Title Issues

State Recording Statutes; Chain of Title. All states have recording statutes that, among other things, require that a conveyance of legal title to real property be evidenced by a writing, signed and notarized (a deed) and recorded in the county in which the property is located. These recording requirements exist to establish priorities of ownership and the interests of third parties. In many states, an unrecorded deed does not impart knowledge of the conveyance evidenced thereby against third parties who did not have notice of the conveyance before the time that they acquired an interest in the real property.

FIRREA grants broad powers to the RTC to acquire real property assets of failed S&Ls by operation of law in connection with its receivership powers. A transfer by operation of law does not require further documentation or action by the parties to finalize the transfer. Therefore, under FIRREA, both legal (record) and equitable (possessory) title to the real property assets of the Old S&L are transferred to the RTC as receiver of the Old S&L at the same time as the appointment of the RTC as receiver, despite the recording requirements of the applicable jurisdiction.

"AN INSURED UNDER A TITLE POLICY INCLUDES A PERSON OR ENTITY WHO ACQUIRES TITLE BY 'OPERATION OF LAW' BUT DOES NOT INCLUDE ONE WHO ACQUIRES TITLE BY PURCHASE. THUS THE RTC, AS RECEIVER OF THE OLD S&L, WOULD SUCCEED TO THE INTERESTS OF ALL TITLE INSURANCE POLICIES ISSUED IN FAVOR OF THE OLD S&L."

The real property assets of the Old S&L, however, are transferred to the New S&L by the purchase and assumption agreement and not "by operation of law." The typical purchase and assumption agreement provides that the New S&L accepts from the RTC, as receiver of the Old S&L, an assignment of, and the RTC, as receiver, "sells, assigns, transfers, conveys and delivers" to the New S&L all "right, title and interest" of the RTC, as receiver, in and to all real property of the Old S&L. Thus, the purchase and assumption agreement is akin to a sale agreement, while at the same time containing conveyancing language required by most state conveyancing laws. A deed to this real property typically is not recorded in conjunction with the purchase and assumption agreement. However,



in some instances, the purchase and assumption agreement itself has been recorded. Assuming the purchase and assumption agreement meets the applicable conveyancing and recording requirements of the jurisdiction within which the real property assets of a failed S&L are located (for example, most states require that the grantor's signature be acknowledged), legal title would be deemed to have passed upon its recording.

In most states, no document is recorded among the public records to show the transfer of the real property assets from the Old S&L to the New S&L. The lack of recordation creates a gap in the chain of title to the real property. This gap presumably will cause the real property assets of the Old S&L transferred without a recording to be unmarketable. The purchaser of real property from the New S&L will expect a deed from the RTC, as conservator of the New S&L, which has the equitable title to the asset. Unless a deed or other appropriate recordable instrument is recorded showing the transfer of the property to the New S&L, the chain of title will not accurately reflect the true sequence of ownership.

To cure the gap created by the purchase and assumption agreement, the RTC in some states records a quitclaim deed or a confirmatory deed to specific real property assets when the assets are sold by the New S&L to a purchaser. Although the recordation of a quitclaim or confirmatory deed at the time of sale of a particular real property asset cures the gap in the chain of title, the gap may exist for a significant period of time between the time when the purchase and assumption agreement is signed and the time when the asset is eventually sold by the New S&L or the RTC. During this time period, the legal and equitable title to the asset is bifurcated, which can obfuscate many title-related matters. These matters include the effect of the recording of liens against real property assets of the Old S&L, which still has recorded property interests.

To avoid these problems, notice of the effect of the purchase and assumption agreement should be recorded in conjunction with its execution. This notice could take any of the following forms:

- a deed to all of the real property assets of the Old S&L with legal descriptions for each specific asset;
- a blanket deed to all real property assets of the Old S&L located in a particular county (without specific legal descriptions). A blanket deed would not prevent the later recordation of a specific deed, if desired;
- a memorandum of the purchase and assumption agreement with specific legal descriptions of the real property assets conveyed, or including a statement that all real property assets in a particular county have been conveyed; or
- the recordation of the purchase and assumption agreement itself, if in recordable form, in each county in each state in which the Old S&L holds title to real property.

Effect of Liens and Encumbrances Recorded Against the Real Property Assets of the Old S&L. 12 U.S.C. Section 1821(d)(13)(C) provides that no attachment or execution may issue by any court upon assets in the possession of the receiver. If any judgment, mechanics' or materialmen's liens are recorded against the real property assets of the Old S&L while those assets are held in the name of the RTC, as receiver, they will be protected from execution by judgment or other creditors. Section 1821(d)(13)(C) seemingly does not provide protection against execution after the sale of the real property for any liens that attach before the receivership, although execution is prohibited during the time the asset is held by the RTC, as receiver. Although Section 1821(d)(13)(C) protects real property assets of the Old S&L from the claims of judgment creditors or other lienholders, the lien will follow the real property asset for which it was recorded. Presumably, before closing on the acquisition of the real property affected by the lien, the buyer will require either that the lien be satisfied or that it receive a discount in the purchase price equal to the amount necessary to satisfy the lien and related expenses.

Section 1821(d)(13)(C) and 12 U.S.C. Section 1825(b) should protect the real property assets of the Old S&L from the recordation of involuntary liens after the date of the receivership and until the date of conveyance to a purchaser of such asset. Because both of these provisions provide that this lien may not attach to the real property asset, then the conveyance from the Old S&L to the New S&L and then to the purchaser should all take priority over any lien recorded during the pendency of the receivership. If a lien was recorded during this period, it would effectively be void *ab initio*.

- **Covenants of Title; Title Insurance.** The RTC, as receiver or conservator, is authorized to dispose of the real property assets of the failed S&L. In connection with disposition, the RTC is empowered to resolve problems affecting these properties. To the extent there are title defects, the RTC, as receiver, should have recourse against the Old S&L's grantor under any title covenants made by the grantor or the Old S&L's title insurer, if there is one. However, whether the New S&L will have any claim against a prior grantor or the Old S&L's title insurer will ultimately depend on the form of the conveyance of title to the real property asset from the Old S&L to the New S&L.

Title covenants generally are considered to be either a "future" covenant or a "present" covenant. A future covenant of title runs with the land and is binding forever on the grantor who makes it. The covenant of warranty is a future covenant which is breached if there is a complete failure of title—for example, if the grantor had no title to convey to the buyer because title was already conveyed to a third party. In this event, the grantee and all future grantees in the chain of title have recourse against such grantor regardless of the type of deed by which a subsequent grantee obtains title. The New S&L should likewise have recourse under future covenants of title even if it acquires legal title from the Old S&L by quitclaim deed.

By contrast, present covenants of title do not run with the land and are enforceable only by an immediate grantee against its immediate grantor. The covenant against encumbrances (e.g., liens and deeds of trust) is the most significant present covenant. By its nature, a present covenant of title ends on the appearance of a quitclaim deed in the chain of title. If the conveyance of legal title to real property by the Old S&L to the New S&L is evidenced by quitclaim deed, it will end present covenants of title running in favor of the Old S&L. The New S&L and any subsequent owner thus would be left without recourse against the Old S&L's grantor if a breach of a present covenant is later discovered. However, if the conveyance by the Old S&L to the New S&L is by general warranty deed in which the Old S&L itself makes present covenants of title, then the New S&L has recourse against the Old S&L, which in turn would have recourse against its immediate grantor and so forth up the chain of title.

As a practical matter, if the Old S&L was liable to the New S&L for a breach of a present covenant of title contained in a general warranty deed, and the Old S&L had title insurance coverage for the title defect, the Old S&L would make a claim against its title insurer. The title insurer would then have the obligation to indemnify the Old S&L for the title defect.

Title insurance policies provide coverage to an insured who is liable for covenants of title that are made by the insured when selling the property. An insured under a title policy includes a person or entity who acquires title by "operation of law" but does not include one who acquires title by purchase. Thus the RTC, as receiver of the Old S&L, would succeed to the interests of all title insurance policies issued in favor of the Old S&L. The New S&L, however, having acquired equitable title by virtue of the purchase and assumption agreement and, eventually, legal title by either warranty or quitclaim deed, would not succeed to these title insurance policies. If the transfer of legal title to the real property assets of the Old S&L to the New S&L is done by quitclaim deed, then the Old S&L would have no continuing liability on any covenants of title. The title insurance policies issued in favor of the Old S&L for these real property assets would thus be effectively terminated, and the cost of curing any title defects may end up being the responsibility of the RTC when disposing of real property assets or resolving associated title problems. To retain the benefits of title insurance policies issued in favor of the Old S&L, the Old S&L presumably would need to convey legal title to the New S&L by general warranty deed, thus retaining the Old S&L in the chain of title warrantors and preserving its right of indemnity against its title insurers under applicable title policies.

Sale of Low-Income Residential Properties

FIRREA includes specific provisions regarding the disposition of certain single-family and multi-family properties to eligible low- and moderate-income families. In disposing of these properties, federal law requires the RTC to:

- give notice to certain parties of the availability of low-income residential properties and provide them with a first right to purchase the property; and
- include a restriction in the conveyancing deed that requires that the property be maintained as available and affordable for low-income families for the remainder of its useful life. 12 U.S.C. Section 1441a.

Failure by the RTC to follow these requirements for any reason may not be used by any person to attack or defeat title once it is conveyed by the RTC. Section 1441a(c) (11) (B) provides that the low-income occupancy requirements of Sections 1441a(2) and 1441a(3) may be judicially enforced by affected low-income families. It is unclear what the result would be if a purchaser of an eligible low-income property takes title without the required deed restrictions. Although Section 1821A(c)(11)(A) seemingly protects the purchaser from losing title to the property, the low-income occupancy restrictions of Sections 1441a(2) and 1441a(3) nevertheless may be specifically enforceable against the purchaser who acquired title free of the deed restriction but subject to Sections 1441a(2) or 1441a(3). Moreover, these provisions may possibly be enforced against a subsequent purchaser who acquires title without notice of the low-income status of the property.

Subdivision Assets

Many real property assets that have been or will be acquired by the RTC, as receiver or conservator, will include subdivisions that are in various stages of completion. In many of these subdivisions, the Old S&L will have "developer" or "declarant" status under the covenants, conditions and restrictions (CC&Rs) applicable to the subdivision. Many CC&Rs contain specific

requirements regarding the assignment of the declarant's rights. For example, the CC&Rs may require that the declarant's rights may not be assigned unless they are assigned under a written document recorded in the public records of the county in which the subdivision is located. Thus, it is unclear whether declarant's rights are assigned automatically to the New S&L through the purchase and assumption agreement between the Old S&L and the New S&L. If not, the New S&L would not have the benefit of the special rights reserved to the declarant under the CC&Rs, such as weighted voting, and thus could lose control of the subdivision's homeowners' association. The declarant's rights could not subsequently be assigned to a purchaser of the New S&L's interest in the subdivision and thus might make the subdivision asset less desirable to a buyer, who presumably would want the control associated with declarant status.

Section 1821(d)(2)(G)(i) (II), which provides that the RTC may, as receiver, transfer any asset of the Old S&L without any assignment, arguably should apply to the transfer of declarant rights, despite any specific assignment provisions of the CC&Rs. Under this provision, which was added by FIRREA, the New S&L would automatically be assigned all declarant's rights in all subdivisions transferred from the Old S&L to the New S&L by the purchase and assumption agreement.

The receivership of the Old S&L also could have a direct effect on the subdivision's continued compliance with applicable federal or state subdivision laws and regulations. For example, a change in the identity of the subdivider may be considered to be a "material change" to subdivision offerings so as to trigger the issuance of an amended subdivision public report. Presumably, the RTC remains subject to the subdivision requirements of the states within which any subdivisions of the Old S&L are located and, to continue to sell lots or units to the public, will need to comply with those requirements. If lot sales are suspended by the applicable governing agency because of a failure to comply with applicable subdivision requirements, the value or marketability, or both, of the subdivision asset could be affected adversely.

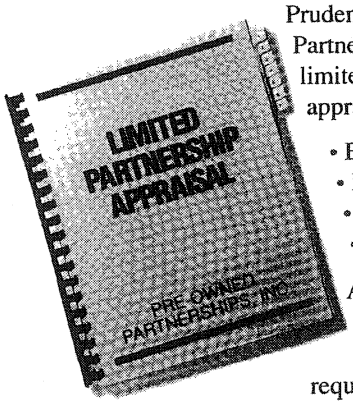
Conclusion

Many of the issues that have resulted from the S&L bailout and the enactment of FIRREA, as they affect real property assets currently owned or disposed of by the RTC, are not capable of immediate resolution. These issues currently are the subject of many legal battles being fought around the country, primarily in those states in which the S&L crisis has hit the hardest. The resolution of many of these issues depends on the policies and procedures of the RTC and its interpretation of FIRREA. Because the implementing rules and regulations under FIRREA and the policies and procedures of the RTC are being instituted, amended or revised constantly, the actual effect that FIRREA will have on the real property assets of failed S&Ls in the United States may not be completely realized for years to come. In the meantime, many of these issues are either left unresolved or left for resolution to the title insurance companies.

Jeffrey J. Miller is an attorney with Streich Lang, P.A., Phoenix, Arizona.

Limited Partnership Appraisals Now Available

Objective. Definitive. Prompt Response.



Prudent professionals rely on Pre-Owned Partnerships for superb fair market valuations of limited partnership interests. Clients use our appraisals for:

- Estate Tax Valuations
- Employee Benefit Plan Terminations
- Asset Management Fee Determinations
- Securities Fraud Litigation

A comprehensive 100-page appraisal costs only $500 and is ready in 10 days. Our appraisals satisfy all IRS and ERISA requirements.

Find out why we do more partnership appraisals and liquidations than anyone else ... and why 97% of our customers are repeat customers. Call for a free copy of a recent appraisal.

Pre-Owned Partnerships • P.O. Box 1909 • Annapolis, MD 21404
(800) 426-6656

COUNSELOR THE INSURANCE COUNSELOR THE INSURANCE COUNSELOR THE INSURANCE COUNSELOR THE INSURANCE COUNSELOR THE INSU

Two new volumes in the series from the Real Property, Probate & Trust Law Section

Split-Dollar Life Insurance

Carefully organized to clarify all aspects of split-dollar life insurance contracts, this guide offers clear explanations of how they work — for both employer and employee — and how they can fit into the financial plans of your clients.

This book will provide you with planning considerations and technical information to allow you to determine when split dollar is appropriate for your clients and to properly implement such contracts where they are indicated.

In addition to definitions, procedures, and strategies, this guide presents a multitude of forms and agreements, case studies, checklists, and reference materials.

1991 8½ x 11 Paper 212 pages
Author: Stanford A. Wynn
Consulting Editor: William B. Lynch
Editor: Michael D. Weinberg

Federal Gift, Estate, and Generation Skipping Transfer Taxation of Life Insurance

This new guide will help you take advantage of opportunities provided by life insurance policies in minimizing transfer taxation in the estate plan — as well as help you avoid the many pitfalls that can arise in these transactions.

The book is divided into four chapters:

I: *Gift Taxation of Life Insurance* including valuation of life insurance, the gift tax annual exclusion, and the gift tax marital deduction.

II: *Estate Taxation of Life Insurance* including discussion of death proceeds under IRC Sections 2042, 2035, and related sections.

III: *Generation Skipping Transfer Taxation of Life Insurance* including application of the GSTT to life insurance owned by trusts and other leveraging techniques.

IV: *Community Property Considerations* including estate tax, gift tax, and GSTT considerations.

Citations to case law and the relevant IRC provisions are provided as well as Tables of Cases and IRC Sections, Regulations and Rulings.

1991 8½ x 11 Paper 129 pages
Authors: Kevin D. Millard, Lawrence Brody, Norman H. Lane
Editor: Michael D. Weinberg

The Insurance Counselor
(formerly called The Life Insurance Counselor)

Please send me:

_____ copies of **The Insurance Counselor: Split-Dollar Life Insurance** (5430317) @
☐ $49.95 (Real Property Sect. members)
☐ $54.95 (regular price)

_____ copies of **The Insurance Counselor: Federal Gift, Estate, and Generation Skipping Transfer Taxation of Life Insurance** (5430316) @
☐ $34.95 (Real Property Sect. members)
☐ $39.95 (regular price)

_____ sets of the above two publications in the "Insurance Counselor" series (5430318) @
☐ $69.95 (Real Property Sect. members)
☐ $79.95 (regular price)

_____ sets of **Life Insurance Products, Illustrations, and Due Diligence** and **Federal Income Taxation of Life Insurance** in the "Insurance Counselor" series (5430300) @
☐ $47.95 (Real Property Sect. members)
☐ $55.95 (regular price)

Total enclosed (add $3.95 per order for handling):
$_____ ☐ Bill me.
☐ Check enclosed made payable to American Bar Association.

Charge to: ☐ VISA ☐ MasterCard

Exp. date: ____/____ Sign.:_____

Acct. #:_____

Name _____

Firm/Org. _____

Address* _____

City/State/Zip _____

Phone number _____

*Street address for UPS delivery.

Mail to: American Bar Association, Order Fulfillment 543, 750 North Lake Shore Drive, Chicago, IL 60611

PAP991

30-day money-back guarantee. Allow 2-3 weeks for delivery.

Keeping Current PROBATE

Keeping Current–Probate offers a look at selected recent cases, rulings and regulations, literature and legislation. The editors of *Probate & Property* welcome any suggestions and contributions from readers.

CASES

• **ESTATE TAX: Gift transfers from revocable trust includable under Section 2035 unless treated as constructive distributions to decedent.** Except in case of incapacity, the grantor of a revocable trust was the sole permissible recipient of income and corpus. Acting as trustee, the grantor made several gift transfers directly from the trust; later, he became incompetent and his successor trustees made additional gift transfers as permitted by the instrument. In *Estate of Jalkut v. Commissioner,* 96 T.C. ___, No. 27 (1991), the transfers made by the grantor while competent were excluded from his estate although made within three years of death, since they could only have been made pursuant to his power of withdrawal. Transfers made by the successor trustees are includable in the gross estate under Sections 2038(a) and 2035(d)(2).

• **ESTATE TAX: Power of incompetent trustee to invade for his own "comfort" causes inclusion of trust in gross estate.** A trust instrument gave the trustees power to invade principal "for the continued comfort, support, maintenance, or education" of the income beneficiary. The beneficiary was appointed as co-trustee with a bank, and never resigned that office despite his adjudicated incompetency. In *Estate of Vissering v. Commissioner,* 96 T.C. ___, No. 33 (1991), the trust assets were included in the beneficiary's estate under Section 2041. The word "comfort" rendered the standard of invasion unascertainable, and the incapacity of the beneficiary did not automatically terminate his trustee powers.

• **GIFT TAX: Disclaimer of a remainder interest in pre-1932 trust generates gift tax.** A trust established in 1917 gave life income interests to the grantor's five children. At the death of the last surviving child, the remainder would vest in the grantor's grandchildren or their issue. One of the grantor's grandchildren, who had learned of her interest in the trust in 1931 when she was 21 years old, disclaimed her interest two months after it vested in 1979, allowing her share to pass to her children. The disclaimer was a transfer subject to gift tax. *Irvine v. U.S.,* No. 89-5616 (8th Cir. 6/10/91).

• **ESTATE TAX PRACTICE: Deferred taxes must be fully paid before refund suit.** An estate elected to defer taxes under section 6166. Later, the Service assessed additional tax, and determined that the estate did not qualify for deferral. In *Racovic v. U.S.,* No. 90-5041 (Fed. Cir. 5/15/91), the estate's suit for refund of the assessment was dismissed for lack of jurisdiction, since the deferred taxes were still unpaid. Section 6166 does not create an exception to the full payment rule of *Flora v. U.S.,* 357 U.S. 63 (1958).

• **ESTATE TAX: Charitable deduction may not exceed value to which charity might have been entitled in absence of settlement.** A contested will made a gift to a charitable pooled income fund, with life interests to children and grandchildren. Testator's prior will had made a contingent charitable gift to the same institution if no grandchildren survived testator's wife and children. The settlement agreement provided a $250,000 cash payment to the charity. In *Terre Haute First National Bank v. U.S.,* No. TH 89-31-C (S.D. Ind. 4/8/91), the charitable deduction was reduced to the actuarial value of the charity's interest under the contested will, since there was no showing that the charity might have been entitled to more under the prior will.

• **PROBATE PRACTICE: Statute denying executor's freedom to discharge lawyer named in will is unconstitutional.** A Louisiana statute provided that an executor may discharge lawyer named in the will only for just cause. In *Succession of Wallace,* 574 So.2d 348 (La. 1991), the statute was overturned as an unconstitutional infringement on the court's exclusive power to regulate the practice of law. The court's disciplinary rules provide that an attorney must withdraw where discharged by a client. In probate matters, the executor, rather than the testator, is the client and is entitled to control the relationship under the disciplinary rule.

• **TORTIOUS INTERFERENCE: Tort action may be coupled with will contest.** Decedent's children contested her will on grounds of undue influence and included an action for tortious interference with expectancy. Although the admis-

sion to probate of a prior will favoring the children would provide an adequate remedy, any such relief is speculative pending the outcome of the will contest. Therefore, the tort claim cannot properly be dismissed. *In re Estate of Knowlston,* 562 N.E.2d 277 (Ill. App. 1990).

• **TORTIOUS INTERFERENCE: Action against deceased tortfeasor for interference with expectancy may be brought during testator's lifetime.** Plaintiffs sued their brother's estate for tortious interference with their expected inheritance from their parents. Although both parents are still living, making damages at least partially contingent upon the final disposition of their property, the tort claim against the deceased brother must be brought now to avoid the nonclaim statute. Some damages, such as those for emotional distress, may be presently determinable. *Carlton v. Carlton,* 575 So.2d 239 (Fla. App. 1991).

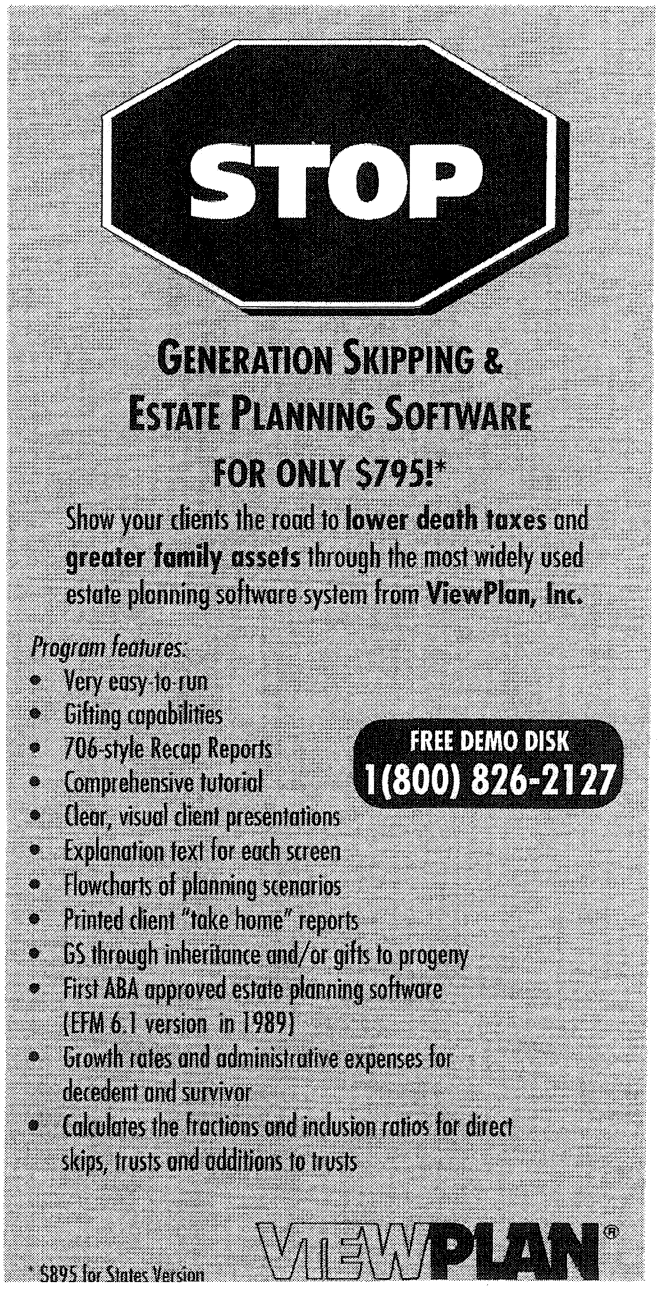
• **UNDUE INFLUENCE: Bequest to attorney/draftsman raises presumption of undue influence.** In *Krischbaum v. Dillon,* 58 Ohio St.3d, 567 N.E.2d 1291 (1991), the Ohio Supreme Court established a rebuttable presumption of undue influence against lawyers drafting will provisions in their own favor, except where the lawyer is related to the testator. Urging the client to seek other advice willl not rebut the presumption. The lawyer must insist by refusing to write the will. Since the presumption relates only to a particular provision, it does not conflict with the statutory presumption favoring validity of a duly executed will.

• **WILLS: Testator's signature below witnesses' is sufficient "subscription."** A printed will form on a single folded sheet of paper provided an execution clause, an attestation clause, and a self-proving affidavit, in that order. Testator did not sign the execution clause but signed the self-proving affidavit, which was otherwise left blank. In *Gardner v. Balboni,* 218 Conn. 220, 588 A.2d 634 (1991), probate of the will was upheld. A will need not be signed precisely at its end and provided the placement of the signature "underneath" is sufficient to protect against incompleteness or later insertions. Since all of the witnesses were dead, the attestation clause was admissible to prove the other elements of due execution, even though the signature of one of the three witnesses had not been validated.

• **JOINT ACCOUNTS: Clear and convincing evidence required to rebut presumption of survivorship rights.** In *Lutz v. Orinick,* 401 S.E.2d 464 (W.Va. 1991), decedent put most of her assets in joint accounts with a friend. Later she executed a will giving her estate to others. A West Virginia statute provides a presumption that funds remaining in a joint account belong to the surviving tenant at the death of the donor depositor, rebuttable only by evidence of fraud, mistake or equally serious fault. The executor's claim to the accounts, grounded in mistake, must be proved by clear and convincing evidence.

• **JOINT ACCOUNTS: Unperfected security interest in joint account is valid against survivor, regardless of notice.** One of the depositors to a joint credit union account borrowed money, pledging the account as security, but did not surrender possession of the passbook. The borrower died before the loan was due. In *Heffernan v. Wollaston Credit Union,* 30 Mass. App. Ct. 171, 567 N.E.2d 933 (1991), the court assumed without deciding that the security interest had not been perfected. Nevertheless, the pledge created an equitable security interest enforceable against the surviving joint tenant, who was not a transferee for value.

• **JOINT ACCOUNTS: Withdrawal of funds by donee tenant upheld where consistent with donor's intent.** Decedent established joint accounts with a neighbor, both as a convenience and to repay the neighbor for care provided to decedent. After decedent was institutionalized, the neighbor withdrew the funds and set up a revocable trust to pay decedent's expenses during her lifetime. In *Nall v. Duff,* 805 S.W.2d 63



(Ark. 1991), the estate's claim to the balance of the trust was denied. A statute made the signature cards conclusive as to the intent to create a joint tenancy. Since a joint tenant is seized of the entire estate, withdrawal of the funds in a manner consistent with the intent of the donor tenant did not terminate ownership of the proceeds.

RULINGS AND REGULATIONS

• **Loan guarantees are taxable gifts and may reduce estate tax marital deduction.** Taxpayer guaranteed various loans made to his children. He proposed to establish a marital deduction estate trust at his death to cover the estimated present value of potential obligations under the guarantees, and a QTIP trust with the rest of his estate. The Service ruled that the guarantee promises are taxable as gifts when made to the extent of the value of the promise. At the time of default and actual payment by the taxpayer, additional gift tax may be imposed. The estate trust will qualify for the marital deduction only to the extent that its value exceeds the face amount of the guarantees. If it is underfunded, the QTIP trust will be totally disqualified because principal might be invaded to pay the guarantees. PLR 9113009.

• **Executor not required to identify assets passing to QTIP.** A will created a QTIP trust, using a pecuniary formula designed to reduce estate taxes to zero. The executor elected to treat as QTIP that fractional share of the trust required to reduce taxes to zero based on final determinations with respect to value and other deductions. In a Technical Advice Memorandum, PLR 9116003, the pecuniary formula was held to be a sufficient identification of the "property interest" subject to the election. Actual selection of assets can await determinations made later in administration of the estate.

• **Service clarifies deductibility of QTIP expenses at death of surviving spouse.** Expenses of a QTIP trust incurred prior to the beneficiary's death and paid by the estate are deductible as claims against the estate. Those incurred after death, including trustee fees and commissions, are deductible only to the extent that they relate to settlement of the beneficiary's estate. Those related to the ongoing conduct of trust activities or to the operation of a business owned by the trust are not deductible. Technical Advice Memorandum, PLR 9121002.

• **Renunciation of partnership interest is not a qualified disclaimer.** Decedent was sole general partner, and held a portion of the limited partnership interests in two firms. His executor and sole beneficiary held the remaining limited interests. The executor voted both her own and the estate's limited partnership shares to elect herself general partner of the two firms, and then renounced her interest in the estate's shares in favor of her children. The disclaimer was not qualified, since her acquiescence in the recapitalization of the partnership by vote of the estate's shares was an act of acceptance. Technical Advice Memorandum, PLR 9123003.

LITERATURE

• **Loan guarantees create tax problems.** August and Kulunas, *Guarantees Have Unexpected Gift Tax and Marital Deduction Consequences in IRS Ruling,* 74 J.Tax. 346 (June 1991), authored by the lawyers requesting PLR 9113009 (summarized above), analyzes the ruling's implications for planning.

• **Keeping up with clients on the move.** Parks, *Special Estate Planning Strategies to Fit the Needs of the Mobile Client,* 18 Estate Planning 150 (May/June 1991), offers advice for dealing with problems of domicile, non-resident aliens and non-citizen spouses.

• **Is life insurance the last, best loophole?** Wilshinsky, *Life Insurance: A New Dimension in Estate Planning,* 130 Trusts & Estates 10 (June 1991), touts the use of insurance for tax-leveraged transfers, with numerous charts and examples.

• **"Divide and diminish" technique may no longer be viable.** Janiga & Harrison, *Valuation of Closely Held Stock for Transfer Tax Purposes: The Current Status of Minority Discounts for Intrafamily Transfers in Family Controlled Corporations,* 69 Taxes 309 (May 1991), explores the Service's unified approach to valuation of family businesses, pointing out the need for caution in applying traditional gifting strategies.

LEGISLATION

• **Power of public fiduciary to administer decedents' estates.** Arizona has increased the powers and duties of the public fiduciary in administering decedents' estates. Act of May 13, 1991, 1991 Ariz. Legis. Serv. Ch. 101 (Westlaw).

• **Connecticut prohibits parent's inheritance from abandoned child.** A parent who abandons a minor child and continues the abandonment until the child's death is not entitled to share in the estate of the child. Act of May 6, 1991, 1991 Conn. Legis. Serv. P.A. 91-64 (S.H.B. 6881) (Westlaw).

• **Powers of trustee-beneficiaries.** Florida disqualifies a trustee who is also a beneficiary of a trust from exercising some trust powers and provides for other trustees or a court-appointed trustee to exercise those powers. Some trusts may be exempted from the act. Act of May 9, 1991, 1991 Fla. Sess. Law Serv. Ch. 91-61 (Westlaw).

• **Georgia revises wills, trusts and administration of estates law.** The act revises and reorganizes the law relating to wills, trusts and the administration of estates. Act of April 11, 1991, 1991 Georgia Laws Act 390 (Westlaw).

• **Distribution of decedent's property by affidavit.** Iowa permits the decedent's successor to obtain estates of personal property only, with a value under $10,000, by giving an affidavit to the property holder stating information entitling the affiant to succeed to the property. Act of April 22, 1991, 1991 Ia. Legis. Serv. S.F. 213 (Westlaw).

• **Nevada simplifies procedure for administering small estates.** The public administrator may administer estates with a gross value in Nevada of less than $2,500 without procuring letters of administration. The act provides a procedure for the public administrator to follow where an estate has a gross value exceeding that amount. Act of April 24, 1991, 1991 Nevada Laws Ch. 116 (Westlaw).

• **New Jersey Declaration of Death Act.** The act permits a declaration of death to be made on the basis of neurological criteria. Act of April 8, 1991, 1991 N.J. Sess. Law Serv. Ch. 90 (Westlaw).

• **New Mexico Adopts Uniform Statutory Will Act.** Act of April 4, 1991, 1991 New Mexico Laws Ch. 173 (Westlaw).

• **Uniform Transfers to Minors Act.** Washington has adopted the Uniform Transfers to Minors Act, effective July 1, 1991. Act of May 15, 1991, 1991 Wash. Legis. Serv. Ch. 193 (Westlaw).

Keeping Current–Probate Editor: Jean T. Adams, 2514 Reynolds Drive, Winston-Salem, NC 27104. Contributing editors: Jean A. Mortland, Dave L. Cornfeld, Mary M. McCormick and Julie A. Lepri.

INDEX TO ADVERTISERS

As a service to readers and advertisers, *Probate & Property* lists each issue's advertisers with a contact name and telephone number, if available, and the page on which the ad appears.

ADVERTISER	PAGE NO.	CONTACT	TELEPHONE
ABA Real Property, Probate and Trust Law Section Books & Videotapes	29, 39, 51	Order Fulfillment	312-988-5555
BNA Tax Management	8, 9	Response Center	800-372-1033
Cammack Computations Co., Inter-Est	28	Cecil Cammack	800-594-5826, Ext. 100
California Association of Realtors	1	Debbie Ferrier	213-739-8291
Chicago Partnership Board, Inc.	Cover 4	Trading Department	800-272-6273
Chicago Title & Trust Company	32, 33		
Deed Analysis System	5	Mary Metz	919-821-1828
Emerald Publications	25		800-233-2834
First Exchange Corporation/ First American Title Insurance Company	Cover 2	Barbara Hester or Jan Tyler	805-962-2269
Lawyers Title Insurance Corporation	Cover 3	Randy Farmer	804-281-6855
Manulife Financial	18, 19	See branch office listing on page 19.	
Pre-Owned Partnerships	50	Brad Davidson	800-426-6656
Charles Schwab & Co., Inc.	23	Trust Services Dept.	800-742-6262, Ext. 31
Skinner, Inc.	38	Ann Androski	508-779-6241
SoftPro Corporation	43	Loren Harrell	800-848-0143
The Travelers Companies	14		
ViewPlan	53	Krysen Ellingson	619-239-3141

Illustration by Beth Littlejohn

APPENDIX A.7

Copyright © 2000. All rights reserved.

A Century's Milestones in Residential Lending

As we usher in the year 2000, the U.S. mortgage industry can claim an impressive array of accomplishments. Today, outstanding mortgage debt totals approximately $4.4 trillion, making it one of the largest, most liquid debt market segments in the world—a market far surpassing the long-term U.S. Treasury debt of $2.5 trillion. Homeownership levels have reached a historical high, which, when tallied for 1999, should be nearly 67 percent.

To understand how we've reached these remarkable heights, we can look to a century's worth of milestones—some assisted through government support, others representing the sheer determination of competitive business professionals.

One hundred years ago, buying a home meant borrowing purchase funds from a friend, relative or local businessperson. Individuals were the largest category of mortgage lender. In our larger communities, savings and loan organizations—then primarily known as building and loans—were the other major source of mortgage financing. By 1900, approximately 5,800 of these institutions held about half a billion dollars in mortgage loans. On a smaller scale, savings banks and state-chartered banks also made home loans.

During the same time, independent mortgage companies numbered approximately 200. Throughout the latter half of the 19th century, mortgage companies acted as conduits between East Coast investors and frontier farmers who needed financing. Rather than purchase loans, most of these mortgages were production loans—funds which bought equipment and supplies, not a property itself.

In 1914, these mortgage companies formed a professional organization called the Farm Mortgage Bankers Association, to ensure lenders' concerns were understood in Washington, D.C. Responding to both an agricultural depression and a nationwide population shift to urban centers following World War I, the organization changed its name in 1923. The word *Farm* was dropped, creating the Mortgage Bankers Association of America (MBA) and reflecting its focus on residential mortgage lending.

As we usher in the year 2000, the U.S. mortgage industry can claim an impressive array of accomplishments.

—Angelo R. Mozilo—

When discussing the industry's milestones, we should keep in mind the structure mortgage loans took during these times. With few exceptions, mortgage loans were primarily five-year, interest-only, 50-percent LTV instruments with principal due at loan end. Principal on a mortgage loan was rarely repaid; most borrowers simply refinanced at the end of five years. This structure proved disastrous after the Great Crash in October 1929.

Today, the hardships of the Great Depression seem unimaginably acute. In the darkest days, one-third of the country's labor force was unemployed. Between 1931 and 1935, there were 250,000 foreclosures per year, and by 1935, 20 percent of all homes were owned by lenders.

Yet it was because of and through this hardship that modern mortgage finance was born.

The Federal Home Loan Bank Act of 1932 extended $125 million in credit to savings and loan institutions, and created the Federal Home Loan Bank System with 12 regional banks. In 1933, the Home Owners Loan Act gave savings and loans the ability to be chartered by the federal government. The thrifts were given basic lending authority to offer emergency relief for homeowners who could refinance their home loan for 20 years.

The terms of these new loans were revolutionary: fixed-rate, amortized loans at rates as low as 5 percent with an 80-percent LTV. By 1936, one in 10 homeowners had received financing through this law. In fact, in the first two years, 1 million loans totaling $3 billion were made, and the amortized fixed-rate loan became the industry standard.

In that same year, the Banking Act of 1933 helped the nation regain some financial confidence by creating the Federal Deposit Insurance Corporation. The Glass-Steagall Act—a law that defied repeal until 1999—redefined the way banks did business. One year later, the National Housing Act of 1934 created the Federal Housing Administration (FHA) and its government-backed insurance program, standardizing loan requirements and enabling lenders to

Copyright © 2000. All rights reserved.

increase liquidity by selling pools of loans to investors, such as life insurance companies.

One of the last pieces of Depression-era legislation created the Federal National Mortgage Association (Fannie Mae), then wholly owned by the government. In 1938, Fannie Mae purchased its first FHA-insured loans from lenders; the nation now had a government-sponsored secondary market to provide further liquidity.

Even with government support, the Depression devastated the lending industry. In the 10-year period between the stock market crash and 1939, half of all banks and thrifts went out of business. The less numerous mortgage companies fared a little better. Thanks to the servicing and processing expertise gained as nonportfolio lenders, many found their niche in government loan originations and servicing.

After World War II, the pent-up demand for homes launched the largest housing expansion the world had ever seen. Five million servicemen had returned home, the GI bill guaranteeing home loans for them all. In addition, Americans had amassed an estimated $44 billion in savings. But homes—especially homes in good condition—were in very short supply. Thus, in 1949 the National Housing Act declared its goal to provide a decent home for every American family.

Merchant builders—the most famous, William Leavitt and his Leavittowns—began erecting thousands of middle-class homes in new suburban subdivisions. Often funded by the FHA, these projects were a boon to lenders. Mortgage companies offered mostly FHA or VA financing to homebuyers, eventually originating 75 percent of all FHA loans. Homeownership rates rose from 55 percent in 1950 to 62 percent in 1960, and one-third of the nation now lived in a suburb.

Throughout the 1950s and 1960s, the thrift industry held at least 50 percent of origination market share. This dominance continued, with thrifts' market share exceeding 70 percent by 1970.

In 1965, the Department of Housing and Urban Development (HUD) was elevated to cabinet-level status. HUD's mission was "a decent, safe and sanitary home and suitable living environment for every American." Both the FHA and Fannie Mae became agencies within HUD, until Fannie Mae's reorganization in 1968. Fannie Mae was split and the "new" Fannie Mae became a private corporation; while another entity, Ginnie Mae, remained an organization within HUD. The privatization of Fannie Mae had immediate effects on the secondary market. In 1965, the GSE purchased $757 million in government mortgage loans. In just five years, that figure grew to slightly more than $5 billion.

Mortgage banking saw revolutionary changes during the 1970s. In this decade, adjustable-rate mortgages were first introduced, launching the public acceptance of shared interest-rate risk. More importantly, the secondary market expanded, unleashing unprecedented capital into mortgage markets. The Emergency Home Finance Act of 1970 not only created Freddie Mac, but empowered Fannie Mae to purchase conventional mortgages.

At the dawn of the 21st century, our industry continues to be a dynamic, growth-oriented sector.

Concurrent with the modern GSE structure, in 1970 Ginnie Mae issued the first mortgage-backed securities. Freddie Mac followed suit in 1971, and by 1975 lenders began to issue their own private mortgage-backed bonds.

Along with the increase of capital made possible by securitization, mortgage lending's major players changed dramatically during the 1980s. At the beginning of the decade, thrifts held 50 percent of originations market share; mortgage companies and commercial banks equally shared the remaining half. Nine short years later, origination market share was divided nearly equally among the three categories, as the thrift industry faced ruin.

In the "mortgage company" category, new, highly competitive members could be found—firms such as Sears, General Electric and General Motors. Large commercial banks like Citicorp and Chase Manhattan made major moves into home finance, as did more than half of the nation's 20,000 credit unions. New origination records were set in 1986 and 1987, before another October stock market crash brought the economic good times to a close.

As the 1990s began, the nation was experiencing another recession. In 1991, the Federal Reserve lowered interest rates and by late 1993, interest for fixed-rate mortgages dropped below 7 percent. Americans had not seen rates this low in 20 years. The result: 1993 saw $1.1 trillion in mortgages funded. It was in this same year that mortgage companies accounted for more than half of originations, with Countrywide Home Loans taking the position of the nation's largest mortgage lender.

Two and a half years later, the Federal Reserve again dropped rates; fixed-rate mortgages went below 7 percent and created another refinance boom that lasted through early spring of 1999. Again, origination records were set. Two refinance booms in one decade were impressive enough, but perhaps more important to the milestones in this decade were mortgage industry consolidation and electronic commerce. Today, the top 25 firms are responsible for more than half of all originations, and more than $4.1 billion in originations were conducted online during 1998.

At the dawn of the 21st century, our industry continues to be a dynamic, growth-oriented sector. As lenders compete to provide personalized service to customers, product diversification is delivering a wealth of opportunities and benefits to borrowers and lenders alike. The quest to offer one-stop shopping for a full array of financial services is being met through innovative technologies, mergers and acquisitions and business-line diversification. The U.S. industry has begun to reach out to the global market.

Through these efforts, among many others, mortgage lenders are setting the stage for growth, prosperity and new milestones for the 21st century.

Angelo R. Mozilo is chairman and chief executive officer of Countrywide Credit Industries, Inc., in Calabasas, California.

APPENDIX A.8

Restatement of the Law — Property
Restatement (Third) of Property: Mortgages
Current through August 2011

Copyright © 1997-2011 by the American Law Institute

Chapter 5. Transfers Of Mortgaged Real Estate And Mortgages

§ 5.4 Transfer Of Mortgages And Obligations Secured By Mortgages

Link to Case Citations

(a) A transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise.

(b) Except as otherwise required by the Uniform Commercial Code, a transfer of a mortgage also transfers the obligation the mortgage secures unless the parties to the transfer agree otherwise.

(c) A mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.

Cross-References:

Section 5.5, Effect of Performance to the Transferor After Transfer of an Obligation Secured by a Mortgage.

Comment:

a. Introduction. This section deals with transfers of mortgages and their associated obligations by an original mortgagee to a successor, or from one successor to another. Such transfers occur in what is commonly termed the secondary mortgage market, as distinct from the primary mortgage market in which mortgage loans are originated by lenders to borrowers.

The essential premise of this section is that it is nearly always sensible to keep the mortgage and the right of enforcement of the obligation it secures in the hands of the same person. This is so because separating the obligation from the mortgage results in a practical loss of efficacy of the mortgage; see Subsection (c) of this section. When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured. This result is economically wasteful and confers an unwarranted windfall on the mortgagor.

It is conceivable that on rare occasions a mortgagee will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed. The far more common intent is to keep the two rights combined. Ideally a transferring mortgagee will make that intent plain by executing to the transferee both an assignment of the mortgage and an assignment, indorsement, or other appropriate transfer of the obligation. But experience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section's purpose is generally to achieve the same result even if one of the two aspects of the transfer is omitted.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

This section applies whether the transfer is outright or is given as collateral or security for some other obligation. When an obligation secured by a mortgage is transferred as collateral for another debt, the person receiving the security interest will generally wish to perfect that interest under U.C.C. Article 9. However, the principles of this section will operate to keep the obligation and the mortgage united whether or not perfection is achieved. Perfection as to the obligation will also constitute perfection as to the mortgage.

b. Transfer of the obligation also transfers the mortgage. A transfer in full of the obligation automatically transfers the mortgage as well unless the parties agree that the transferor is to retain the mortgage. The objective of this rule, as noted above, is to keep the obligation and the mortgage in the same hands unless the parties wish to separate them. This result is sometimes justified on the ground that "[a]ll the authorities agree that the debt is the principal thing and the mortgage an accessory," as the United States Supreme Court put it in 1872 in Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 21 L.Ed. 313 (1872).

Ownership of a contractual obligation can generally be transferred by a document of assignment; see Restatement, Second, Contracts § 316. However, if the obligation is embodied in a negotiable instrument, a transfer of the right to enforce must be made by delivery of the instrument; see U.C.C. § 3-203 (1995). The principle of this subsection, that the mortgage follows the note, applies to either form of transfer of the note. Moreover, it applies even if the transferee does not know that the obligation is secured by a mortgage. See Illustrations 1-3.

Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it. However, assignees are well advised to record. One reason is that, if the assignment is not recorded, the original mortgagee appears in the public records to continue to hold the mortgage. If the mortgagee and mortgagor subsequently enter into and record a purported discharge or modification of the mortgage without the assignee's knowledge or involvement, and the real estate is then transferred to a good faith purchaser for value, the latter is entitled to rely on the record. The result is to prevent the assignee from enforcing the mortgage, in its original form, against the purchaser.

Illustrations:

1. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes a separate "Assignment of Promissory Note" transferring ownership of the note to Assignee, but makes no mention and no express assignment of the mortgage. By this transfer Assignee becomes the owner of both the note and the mortgage.2. The facts are the same as Illustration 1, except that the note is negotiable, and that rather than executing an assignment of the note to Assignee, Mortgagee delivers the note to Assignee for the purpose of giving Assignee the right to enforce the note. By this transfer Assignee becomes the owner of both the note and the mortgage.3. The facts are the same as Illustration 1 or Illustration 2, except that Assignee has no knowledge that the note is secured by a mortgage. The result is the same as in Illustrations 1 and 2.

A transfer of the obligation with a retention of the mortgage is possible, but only if the transferor and transferee so agree. See Illustration 4. If the full obligation is transferred without the mortgage, the effect of such a transfer under Subsection (c) of this section is to make it impossible to foreclose the mortgage, and hence to make it practically a nullity, unless the transferor is also made the transferee's agent or trustee with authority to foreclose in the transferee's behalf. See Comment *e*.

Illustration:

4. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes an "Assignment of Promissory Note" transferring ownership of the note to Assignee, which expressly provides that "the mortgage securing this note is not assigned to Assignee, but is retained as Mortgagee's property." By this transfer Assignee becomes the owner of the note, but not of the mortgage.

There is one situation in which a retention of the mortgage by the transferor of the obligation may be sensible and desirable. That is where the obligation is bifurcated. This may occur, for example, because the original mortgagee transfers only a partial interest in the secured obligation while retaining the residue, or because the obligation is represented by two notes and the original mortgagee transfers one of them while retaining the other. The obligation or the mortgage may, of course, contain terms either authorizing or prohibiting such transfers, and stating how the real estate mortgage is to be dealt with in the event of such a partial transfer of the obligation.

If these documents do not deal with the matter, the parties to the transaction, if well advised, will expressly agree as to the disposition of the security, and thus may express the intent mentioned in § 5.4(a). They may agree either that the mortgage is to pass to the transferee, or that it is to be retained by the transferor. Conceivably, they may agree that it is to be divided between the parties on some basis. If no specific intent is expressed by the parties, either in the original documents or at the time of the transfer, the effect of a partial transfer of the obligation, under § 5.4(a), will be to bifurcate the mortgage as well, and to transfer a proportionate interest in it to the partial transferee of the obligation, leaving the remainder in the transferor's hands. This result is cumbersome, but there is no fair and feasible alternative if the parties fail to agree on the disposition of the mortgage.

c. Transfer of the mortgage also transfers the obligation. When ownership of a mortgage is assigned to another, Subsection (b) of this section provides that the obligation secured by the mortgage is likewise transferred unless the parties agree that the obligation be retained by the transferor. In effect, the obligation will "follow" the mortgage even if not expressly mentioned in any document of transfer. The reason, as noted above, is that this is ordinarily what the parties desire and expect when a mortgage is assigned. Thus this section is designed to carry out the parties' intention even though they, through ignorance or inadvertence, have not fully documented it. See Illustrations 5 and 6. If the obligation is only partially owned by the transferor, or if the obligation is subject to prior liens or security interests, only the interest of the transferor in the obligation passes to the transferee.

Illustrations:

5. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, as security for payment of the note, a mortgage on Blackacre. Mortgagee negotiates a sale of the loan to Assignee. Mortgagee executes an assignment of the mortgage to Assignee, but the assignment makes no express mention of the note. Ownership of the note passes to Assignee with the mortgage despite the absence of any express transfer of the note.6. The facts are the same as Illustration 5, except that instead of executing an assignment of the mortgage, Mortgagee executes and delivers a deed of Blackacre to Assignee. The result is the same as in Illustration 5.

It is possible for a mortgagee to assign the mortgage while retaining full ownership of the obligation, but only if the parties so agree. See Illustration 7. The practical effect of such a transaction is to make it impossible to foreclose the mortgage, unless the transferee is also made an agent or trustee of the transferor or otherwise has authority to foreclose in the transferor's behalf. See Comment *e*.

Illustration:

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

7. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes an assignment of the mortgage to Assignee, but the assignment expressly provides that "ownership of the promissory note secured by this mortgage is retained by Mortgagee, and Assignee acquires no interest in it." Assignee becomes the owner of the mortgage but not owner of the promissory note. Unless Assignee is authorized by Mortgagee to do so on Mortgagee's behalf, Assignee may not foreclose the mortgage.

If the mortgage obligation is a negotiable note, Uniform Commercial Code § 3-203 (1995) is generally understood to make the right of enforcement of the note transferrable only by delivery of the instrument itself to the transferee. Hence, when a mortgage is assigned but the negotiable note it secures is not delivered, the courts may find it necessary to disregard the rule of Subsection (b) in order to effectuate the Code.

Institutional purchasers of loans in the secondary mortgage market often designate a third party, not the originating mortgagee, to collect payments on and otherwise "service" the loan for the investor. In such cases the promissory note is typically transferred to the purchaser, but an assignment of the mortgage from the originating mortgagee to the servicer may be executed and recorded. This assignment is convenient because it facilitates actions that the servicer might take, such as releasing the mortgage, at the instruction of the purchaser. The servicer may or may not execute a further unrecorded assignment of the mortgage to the purchaser. It is clear in this situation that the owner of both the note and mortgage is the investor and not the servicer. This follows from the express agreement to this effect that exists among the parties involved. The same result would be reached if the note and mortgage were originally transferred to the institutional purchaser, who thereafter designated another party as servicer and executed and recorded a mortgage assignment to that party for convenience while retaining the promissory note. Again, the parties' agreement that ownership of the note should remain in the purchaser would be enforced.

Occasionally a mortgagee may wish to assign the mortgage in full, but to retain a partial interest in the obligation. For example, if the mortgage secures two notes, the mortgagee might transfer one note (along with the mortgage) and retain the other. There is no objection to such a transaction if the parties so agree. The portion of the obligation remaining in the mortgagee's hands will be unsecured, while the portion acquired by the transferee will be secured by the entire mortgage.

d. Competing transfers of obligations and mortgages. This section's focus is on the relationship between the transferor and transferee of obligations and mortgages that secure them. It does not purport to resolve conflicts resulting from multiple purported transfers by a transferor to competing transferees. That subject is complex and is governed by other bodies of law, including the recording acts and the Uniform Commercial Code, that are beyond the scope of this Restatement.

e. Mortgage may not be enforced except by a person having the right to enforce the obligation or one acting on behalf of such a person. As mentioned, in general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation. For example, assume that the original mortgagee transfers the mortgage alone to A and the promissory note that it secures to B. Since the obligation is not enforceable by A, A can never suffer a default and hence cannot foreclose the mortgage. B, as holder of the note, can suffer a default. However, in the absence of some additional facts creating authority in A to enforce the mortgage for B, B cannot cause the mortgage to be foreclosed since B does not own the mortgage. See Illustration 8.

This result is changed if A has authority from B to enforce the mortgage on B's behalf. For example, A may be

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

a trustee or agent of B with responsibility to enforce the mortgage at B's direction. A's enforcement of the mortgage in these circumstances is proper. See Illustration 9. The trust or agency relationship may arise from the terms of the assignment, from a separate agreement, or from other circumstances. Courts should be vigorous in seeking to find such a relationship, since the result is otherwise likely to be a windfall for the mortgagor and the frustration of B's expectation of security. See Illustration 10.

Illustrations:

8. The facts are the same as Illustration 4. If Mortgagor defaults in payment of the promissory note, Assignee may sue on the note, but neither Mortgagee nor Assignee may enforce the mortgage.9. The facts are the same as Illustration 4, except that the assignment of the note further states, "Mortgagee is hereby designated agent of Assignee with a duty to foreclose the mortgage upon Assignee's request." If Mortgagor defaults in payment of the promissory note, Assignee may sue on the note, and Mortgagee must foreclose the mortgage if directed by Assignee to do so, subject to the provisions of § 8.2.10. The facts are the same as Illustration 4, except that Mortgagee has often served as Assignee's agent in the past with authority to foreclose mortgages held by Assignee. A court is warranted in finding on the basis of this pattern of prior conduct that Mortgagee is Assignee's agent for purposes of foreclosing the instant mortgage. Upon such a finding, Mortgagee must foreclose the mortgage if directed by Assignee to do so, subject to the provisions of § 8.2.

REPORTERS' NOTE

Introduction, Comment a. General commentaries on the transfer of mortgages and their associated obligations include 1 G. Nelson & D. Whitman, Real Estate Finance Law §§ 5.27-5.35 (3d ed. 1993); G. Glenn, Mortgages § 314 (1943); Ellis & Lowry, A Comprehensive Note Purchase Guide (with Forms), Part I, Prac. Real Estate Lawyer 45 (July 1987); Part II, Prac. Real Estate Lawyer 49 (Sept.1987); Bautista & Kennedy, The Imputed Negotiability of Security Interests Under the Code, 38 Ind. L.J. 574 (1963); Note, Transfer of the Mortgagee's Interest in Florida, 14 U. Fla. L. Rev. 98 (1961); Britton, Assignment of Mortgages Securing Negotiable Notes, 10 Ill. L. Rev. 337 (1915).

The mortgage becomes useless in the hands of one who does not also hold the obligation because only the holder of the obligation can foreclose; see In re Atlantic Mortg. Corp., 69 B.R. 321 (Bankr.E.D.Mich.1987); Swinton v. Cuffman, 213 S.W. 409 (Ark.1919); Stribling v. Splint Coal Co., 5 S.E. 321 (W.Va.1888). When a separation of the two has occurred, some courts have imposed a constructive trust on the mortgage in favor of the holder of the obligation in order to make it available for foreclosure; see Lawrence v. Knap, 1 Root (Conn.) 248, 1 Am.Dec. 42 (1791); Pettus v. Gault, 71 A. 509 (Conn.1908); Kinna v. Smith, 3 N.J.Eq. 14 (1834); Rembert v. Ellis, 17 S.E.2d 165 (Ga.1941), noted 137 A.L.R. 479. The essential desirability of avoiding a separation of the obligation and the mortgage has been explained thus:

> Among the "gems" and "free offerings" of the late Professor Chester Smith of the University of Arizona College of Law was the following analogy. The note is the cow and the mortgage the tail. The cow can survive without a tail, but the tail cannot survive without the cow.

Best Fertilizers of Arizona, Inc. v. Burns, 571 P.2d 675, 676 (Ariz.Ct.App.1977), reversed on other grounds, 570 P.2d 179 (Ariz.1977). See also Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 21 L.Ed. 313 (1872).

Transfer of the obligation also transfers the mortgage, Comment b. Illustrations 1 and 2 are supported by In re Ivy Properties, Inc., 109 B.R. 10 (Bankr.D.Mass.1989); In re Union Packing Co., 62 B.R. 96 (Bankr.D.Neb.1986); First National Bank v. Larson, 17 B.R. 957, 965 (Bankr.D.N.J.1982); Rodney v. Arizona

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Bank, 836 P.2d 434 (Ariz.Ct.App.1992); Campbell v. Warren, 726 P.2d 623 (Ariz.Ct.App.1986) (an assignment of a portion of the payments from a promissory note automatically transfers a *pro tanto* interest in the mortgage that secures the note); Domarad v. Fisher & Burke, Inc., 76 Cal.Rptr. 529 (Cal.Ct.App.1969); Margiewicz v. Terco Properties, 441 So.2d 1124 (Fla.Dist.Ct.App.1983); Moore v. Lewis, 366 N.E.2d 594 (Ill. App. Ct. 1977); Jones v. Titus, 175 N.W. 257 (Mich. 1919); Goetz v. Selsor, 628 S.W.2d 404 (Mo.Ct.App.1982); Kernohan v. Manss, 41 N.E. 258 (Ohio 1895); Bartlett Estate Co. v. Fairhaven Land Co., 49 Wash. 58, 94 P. 900 (1908). See generally G. Glenn, Mortgages § 314 (1943).

See also Ala. Code § 8-5-24: "The transfer of a ... note given for the purchase of lands ... passes to the transferee the lien of the vendor of the lands"; Ariz. Rev. Stat. § 33-817: "The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts"; West's Ann. Cal. Civil Code § 2936: "The assignment of a debt secured by a mortgage carries with it the security."

Some cases reach the same result as this subsection by finding that the transferor of the note is a constructive trustee of the mortgage for the benefit of the transferee. See, e.g., Pettus v. Gault, 71 A. 509 (Conn.1908); Rembert v. Ellis, 17 S.E.2d 165, 137 A.L.R. 479 (Ga. 1941); Kinna v. Smith, 3 N.J.Eq. 14 (1834).

Illustration 3 is based on Mankato First National Bank v. Pope, 89 N.W. 318 (Minn.1902). See also Edwards v. Bay State Gas Co., 184 Fed. 979 (C.C. Del. 1911); Holland Banking v. See, 130 S.W. 354 (Mo.Ct.App.1910); Betz v. Heebner, 1 Pen. & W. 280 (Pa.1830).

With respect to Illustration 4, there is substantial authority that the note and the mortgage are "inseparable." Several of the cases cited above in connection with Illustrations 1 and 2 so state; see Hill v. Favour, 84 P.2d 575 (Ariz.1938). However, under this Restatement a separation of the two rights is permissible if the parties so intend, although under Subsection (c) of this section the person who then owns the mortgage is generally unable to enforce it.

A partial transfer of the obligation effects a partial or pro tanto transfer of the mortgage as well, in the absence of contrary intent. See Allen v. Hamman Lumber Co., 34 P.2d 397 (Ariz.1934); Anderson Banking Co. v. Gustin, 146 N.E. 331 (Ind.Ct.App.1925); New England Loan & Trust Co. v. Robinson, 76 N.W. 415 (Neb.1898) ; Hyman v. Sun Ins. Co., 175 A.2d 247 (N.J. Super. Ct. 1961). However, the case law offers little guidance as to the practical management of such a bifurcated mortgage. Who has the power to make decisions regarding foreclosure, forbearance, and the like? Presumably the courts will permit those holding a majority interest in the obligation and mortgage to decide these questions, but the matter is unclear. See Perkins v. Chad Devel. Corp., 157 Cal.Rptr. 201 (Cal.Ct.App.1979), holding that where the mortgage is held by two co-owners, either of them has the power to foreclose without the consent of the other.

Questions may also arise concerning the relative priority of the parties in the proceeds of mortgage foreclosure. Modern case law generally treats them as pro-rata participants if there is no contrary agreement. See Perkins v. Chad Devel. Corp., 157 Cal.Rptr. 201 (Cal.Ct.App.1979); Domeyer v. O'Connell, 4 N.E.2d 830 (Ill.1936); Farr v. Hartley, 81 P.2d 640 (Ut.1938); 1 G. Nelson & D. Whitman, Real Estate Finance Law § 5.35 (3d ed. 1993); G. Glenn, Mortgages § 318 (1943). Well-advised parties will, of course, enter into a "participation agreement" dealing with all of these issues.

Transfer of the mortgage also transfers the obligation, Comment c. Illustration 5 is based on Gregg v. Williamson, 98 S.E.2d 481 (N.C.1957) (statement in margin of public records assigning a mortgage had the effect of transferring the note as well). See United States v. Freidus, 769 F.Supp. 1266 (S.D.N.Y.1991); Seabury v. Hem-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

ley, 56 So. 530 (Ala.1911); Andrews v. Townshend, 1 N.Y.S. 421 (N.Y. Super. Ct. 1888); Loveridge v. Shurtz, 70 N.W. 132 (Mich.1897); Foster v. Trowbridge, 40 N.W. 255 (Minn.1888). See also Lawson v. Estate of Slaybaugh, 619 S.W.2d 910 (Mo.Ct.App.1981) (while an assignment of the mortgage without the note is ordinarily a nullity, it might be held to transfer the note if that was the intention of the assignor); In re United Home Loans, Inc., 71 B.R. 885 (W.D.Wash.1987) (where mortgage is assigned by document which states that the debt is also being transferred, ownership of the note passes to the assignee even though the note is not indorsed or delivered). See Kan. Stat. Ann. § 58-2323: "The assignment of any mortgage as herein provided shall carry with it the debt thereby secured."

There is also substantial contrary authority, holding that an assignment of the mortgage without the obligation is a nullity. That authority is not followed by this Restatement. See In re Hurricane Resort Co., 30 B.R. 258 (Bankr.Fla.1983); Hill v. Favour, 84 P.2d 575 (Ariz.1938); Domarad v. Fisher & Burke, Inc., 76 Cal.Rptr. 529 (Cal.Ct.App.1969) (dictum); Hamilton v. Browning, 94 Ind. 242 (1883); Pope & Slocum v. Jacobus, 10 Iowa 262 (1859); Van Diest Supply Co. v. Adrian State Bank, 305 N.W.2d 342 (Minn.1981); Kluge v. Fugazy, 536 N.Y.S.2d 92 (N.Y.App.Div.1988); Miller v. Berry, 104 N.W. 311 (S.D.1905). See Note, Transfer of the Mortgagee's Interest in Florida, 14 U. Fla. L. Rev. 98 (1961).

Illustration 6 is based on Carr v. Dorenkamper, 556 N.E.2d 1333 (Ind.Ct.App.1990) (quitclaim deed, effective as an "equitable assignment"). See also Welsh v. Phillips, 54 Ala. 309, 25 Am.Rep. 679 (1875) (warranty deed); Ruggles v. Barton, 79 Mass. (13 Gray) 506 (1859); Hinds v. Ballou, 44 N.H. 619 (1863) (quitclaim deed); Welch v. Priest, 90 Mass. (8 Allen) 165 (1864) (release effective to transfer mortgage and obligation). See generally Rollison, Priorities in the Law of Mortgages, 9 Notre Dame Law. 50 (1933).

There is substantial older authority that a conveyance of the land by the mortgagee is a nullity rather than a transfer of both the mortgage and the obligation. See Peters v. Jamestown Bridge Co., 5 Cal. 334, 63 Am.Dec. 134 (1855); Carter v. Bennett, 4 Fla. 283, 347 (1852); Delano v. Bennett, 90 Ill. 533 (1878); Johnson v. Cornett, 29 Ind. 59 (1867); Swan v. Yaple, 35 Iowa 248 (1872); Farnsworth v. Kimball, 91 A. 954, 956 (Me.1914); Smith v. Smith, 15 N.H. 55, 65 (1844); Devlin v. Collier, 22 A. 201 (N.J. 1891); Merritt v. Bartholick, 36 N.Y. 44 (1867). This Restatement does not follow that authority; since the mortgage is plainly an interest in real estate, it is difficult to see why a deed of the land should not be construed as assigning it.

Competing transfers of obligations and mortgages, Comment d. The principle permitting a subsequent good faith purchaser of a note to prevail over a prior assignee of the mortgage who did not obtain the note is supported by In re Vermont Fiberglass, Inc., 44 B.R. 505 (Bankr.D.Vt.1984); Nazar v. Southern, 32 B.R. 761 (Bankr.Kan.1983); Second Nat. Bank v. Dyer, 184 A. 386 (Conn.1936); and Price v. Northern Bond & Mortg. Co., 297 P. 786 (Wash. 1931). The conclusion favoring the second taker is more probable when the note is negotiable; see generally 1 G. Nelson & D. Whitman, Real Estate Finance Law § 5.34 (3d ed. 1993); G. Glenn, Mortgages § 315.2 (1943).

Mortgage may not be enforced except by the owner of the obligation or one acting on behalf of the owner, Comment d. Illustration 8 is explained as follows in In re Belize Airways Limited, 7 B.R. 604, 606 (Bankr.S.D.Fla.1980):

> To allow the assignee of a security interest [who did not also acquire the note] to enforce the security agreement would expose the obligor to a double liability, since a holder in due course of the promissory note clearly is entitled to recover from the obligor. Section 3-305, Uniform Commercial Code.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

See also G. Glenn, Mortgages § 314 (1943):

To transfer the mortgage and keep the debt would be futile at best.... [T]he transfer would be ineffectual, because the mortgagee's real interest in the property is a security interest. A mortgagee who parts with this security to a stranger, loses its benefit, nor can the stranger profit, unless he was a *bona fide* purchaser, a case that can happen if the mortgage has taken the form of an absolute deed.

By analogy, U.C.C. § 1-201(37) (1995) defines a security interest as "an interest in personal property ... which secures payment or performance of an obligation." Case law construing the Code holds that a security interest is unenforceable in the absence of its underlying obligation. See Bank of Lexington v. Jack Adams Aircraft Sales, 570 F.2d 1220 (5th Cir.1978). Hence, "in order for a creditor to have lien rights in the property of a debtor, the creditor must hold an enforceable obligation against the debtor"; In re G.O. Harris Financial Corp., 51 B.R. 100 (Bankr.S.D.Fla.1985). See Sobel v. Mutual Development Inc., 313 So.2d 77 (Fla.Dist.Ct.App.1975).

Because a transfer of the mortgage without the obligation is essentially futile, a court may strain to find that the holder of the mortgage holds it in trust for the benefit of the owner of the obligation. See Boruchoff v. Ayvasian, 79 N.E.2d 892 (Mass. 1948).

Research References

1. Digest System Key Numbers

Mortgages ⚷ 219-270.

2. A.L.R. Annotations

Applicability of article 9 of Uniform Commercial Code to assignment of rights under real-estate sales contract, lease agreement, or mortgage as collateral for separate transaction. 76 ALR4th 765.

Comment Note: Effectiveness, as pledge, of transfer of non-negotiable instruments which represent obligation. 53 ALR2d 1396.

Recording laws as applied to assignment of mortgages on real estate. 89 ALR 171, Supp. 104 ALR 1301.

Case Citations

Case Citations through June 2010

— April 2011Case Citations July 2010 — April 2011

Case Citations through June 2010:

C.D.Cal.Bkrtcy.Ct.2008. Quot. in sup. Corporation that was named as beneficiary "acting solely as a nominee" for mortgage lender and "lender's successors and assigns" under a deed of trust supporting an adjustable-rate promissory note filed a motion on behalf of itself and "its assignees and/or successors in interest" for relief from stay in Chapter 7 debtor's bankruptcy case. This court denied the motion, holding, inter alia, that corporation's unidentified "assignees and/or successors in interest" were not permitted in a motion before

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

the court. Noting that corporation had presented no evidence as to who owned the note or of any authorization to act on behalf of the present owner, the court pointed out that, if, as was likely, lender had transferred the note, corporation was no longer an authorized agent of the holder unless it had a separate agency contract with the new undisclosed principal; assignment of a note carried the mortgage with it, while an assignment of the latter alone was a nullity. In re Vargas, 396 B.R. 511, 516.

D.Conn.Bkrtcy.Ct.2010. Cit. in case quot. in ftn. U.S. Trustee moved to dismiss debtor's Chapter 11 case. Dismissing the case, this court held, inter alia, that debtor's use of his Chapter 11 case as a platform to impermissibly attack the final orders in state-court foreclosure proceedings with respect to a certain first mortgage on property in which debtor claimed an interest constituted "other cause" for dismissal of his bankruptcy case. Pointing to debtor's attempt to relitigate the note holder's standing, established in the foreclosure action, the court observed that Connecticut statutory law permitted the holder of a note to foreclose on property when the mortgage had not yet been assigned to him, codifying the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. In re Van Eck, 425 B.R. 54, 61.

D.D.C.1999. Com. (a) quot. in disc. Buyers of property sued the FDIC, as receiver for the beneficiary of a deed of trust securing two promissory notes, and the parties to which the FDIC transferred the promissory notes and the deed of trust, seeking to avoid foreclosure and to clear title to the property. This court granted buyers summary judgment, holding, inter alia, that the FDIC's June 29, 1993 assignment of the deed of trust transferred all of FDIC's mortgage interest in the deed of trust as opposed to a partial interest. The court stated that it knew of no principle or premise supporting the view that a holder of two obligations secured by the same mortgage could not transfer the entirety of the mortgage interest with just one of the underlying obligations, leaving the second obligation unsecured. Crosby v. First Bank of Beverly Hills, 77 F.Supp.2d 1, 5.

D.V.I.2002. Subsec. (a) quot. in sup. and ftn., com. (b) quot. in sup. Assignee of mortgage loan guaranteed by Small Business Administration (SBA) sued to foreclose on mortgages on individual defendants' properties. This court granted plaintiff summary judgment, holding that plaintiff's suit was timely under unlimited federal statute of limitations of 28 U.S.C. § 2415, since individual mortgages were transferred to SBA in 1994 when it paid off underlying loan to one of the individuals. Plaintiff, as assignee of SBA's interest, stood in agency's shoes, and thus benefited from unlimited statute. Since mortgage automatically followed promissory note, individual mortgages securing guaranty traveled with note when it was assigned to SBA. UMLIC VP LLC v. Matthias, 234 F.Supp.2d 520, 523.

Conn.1998. Cit. in disc. Mortgagee/bank moved to open a foreclosure judgment in order to correct the inadvertent omission of a parcel of the mortgaged property from the judgment. The trial court granted the motion, but the intermediate appellate court reversed, finding that the controlling statutory sections deprived the lower court of jurisdiction to open a judgment of foreclosure. Reversing and remanding, this court held that the statute in question did not preclude trial courts from exercising their equitable discretion to correct inadvertent omissions in mortgage foreclosure proceedings, and that this decision was consistent with both public policy and the doctrine of marshaling, which required a mortgagee, in the case of a mortgage secured by several parcels of realty, to foreclose first on those parcels not securing junior encumbrances. Furthermore, bank's failure to enforce its right to a deficiency judgment against mortgagors did not render the mortgage on the omitted parcel of property unenforceable. New Milford Sav. Bank v. Jajer, 244 Conn. 251, 708 A.2d 1378, 1387.

Conn.App.2006. Cit. in sup. After mortgage-note holder initiated foreclosure proceedings against mort-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

gagor, mortgagor moved to dismiss, alleging that note holder lacked standing to enforce the note and mortgage because it was not an assignee of the mortgage when it initiated the action. The trial court denied defendant's motion to dismiss. Affirming and remanding, this court held that the trial court properly found that plaintiff was the holder of the mortgage note prior to the commencement of this action, and thus had standing to enforce the note and mortgage under a state statute permitting the holder of a negotiable instrument that was secured by a mortgage to foreclose on the mortgage even when the mortgage had not yet been assigned to him. The court observed that the statute codified the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. Bankers Trust Co. of California, N.A. v. Vaneck, 95 Conn.App. 390, 392, 899 A.2d 41, 42.

Conn.App.2010. Cit. in case quot. in sup. Trustee of structured asset investment loan trust brought a foreclosure action against mortgagor. The trial court denied defendant's motion to dismiss. Affirming and remanding, this court held that plaintiff, as a bona fide holder of the promissory note secured by the mortgage on defendant's property, had standing to bring its foreclosure action, even assuming that the assignment of the mortgage from the original mortgagee's nominee to plaintiff was invalid. The court explained that, under a Connecticut statute, the holder of a negotiable instrument that was secured by a mortgage was permitted to foreclose on the mortgage even when the mortgage had not yet been assigned to him; the statute codified the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. Chase Home Finance, LLC v. Fequiere, 119 Conn.App. 570, 576, 989 A.2d 606, 611,

Mo.App.2009. Coms. (a)–(e) cit. in disc. Purchaser of real property at a tax sale brought a quiet-title action against delinquent taxpayer and assignee of the deed of trust from a nominee of taxpayer's mortgage lender. The trial court denied assignee's motion for summary judgment and granted summary judgment for plaintiff. Affirming, this court held that assignee had no legally cognizable interest in the property, and thus lacked standing to seek dismissal of plaintiff's petition; since the assignor never held the promissory note, its assignment of the deed of trust to assignee separately from the note had no force. Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623.

N.Y.Sup.Ct.2010. Subsec. (b) cit. in ftn. Mortgagee sued to foreclose a mortgage on residential real property. Granting plaintiff's motion for partial summary judgment, this court held that plaintiff, as assignee of the note and qualifying mortgage, had standing to bring its foreclosure action. The court found that where, as here, an entity such as a mortgage electronic registration system was identified in the mortgage indenture as the nominee of the lender and as the mortgagee of record, and the mortgage indenture conferred upon such nominee all of the powers of the lender, its successors, and assigns, a written assignment of the note and mortgage by the registry, in its capacity as nominee, conferred good title to the assignee and was not defective for lack of an ownership interest in the note at the time of the assignment. The court stated that such an assignment did not violate this state's rule that transfer of a mortgage without a concomitant transfer of the debt was void; the court noted that this rule was at odds with the common-law rule that, generally, a transfer of the mortgage also transferred the debt. US Bank, N.A. v. Flynn, 27 Misc.3d 802, 897 N.Y.S.2d 855, 859.

— April 2011:Case Citations July 2010 — April 2011:

E.D.Mich.2010. Cit. in ftn. Borrower that defaulted on a commercial mortgage loan sued lender, as second assignee of the loan, arguing that the first mortgage assignment to a trust was accomplished by three separate

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

unrecorded interim assignments, such that the record chain of title was rendered fatally defective, and thus foreclosure by advertisement by any party was precluded. This court denied plaintiff's motion for reconsideration of its order denying with prejudice plaintiff's motion for a temporary restraining order and preliminary injunction. The court rejected plaintiff's argument that the various contracts assigning the notes and mortgages to interim mortgagees might have reserved rights in the original noteholder, or might have lacked consideration, or might not have been valid under the laws of the state governing those contracts, noting that plaintiff cited no binding authority contradicting the Michigan doctrine that a transfer of a note transferred the mortgage by operation of law—without regard to any agreement otherwise. Livonia Property Holdings, L.L.C. v. 12840–12976 Farmington Road Holdings, L.L.C., 717 F.Supp.2d 724, 751–752.

W.D.Mo.Bkrtcy.Ct.2010. Com. (a) cit. in ftn. Assignee of a deed of trust on Chapter 7 debtor's residence filed a motion for relief from automatic stay with regard to the residence; debtor's trustee challenged assignee's standing to seek relief from the stay, asserting that the deed of trust was unenforceable because assignee was not the holder of both the note and deed of trust on the date of the bankruptcy filing. Granting the motion, this court held that assignee had standing because, when the holder of a promissory note assigned or transferred the note, the deed of trust was also transferred, and an assignment of the deed of trust separate from the note had no "force"; effectively, a promissory note and a deed of trust were inseparable, and when the note was transferred, it vested in the transferee all interest, rights, powers, and security conferred by the deed of trust upon the beneficiary therein and the payee in the note. In re Tucker, 441 B.R. 638, 641.

Md.Spec.App.2010. Subsec. (c) cit. in sup. Substitute trustees appointed by successor to noteholder to enforce its collection rights brought a foreclosure action against mortgagors. The trial court denied mortgagors' motion for an injunction to prevent the foreclosure sale. Affirming, this court held, inter alia, that mortgagors were not entitled to an injunction, because successor was a non-holder in possession of the note who had the rights of a holder, including the right to enforce the note; thus, successor had the same rights as noteholder to name successor trustees to enforce its collection rights, and trustees had standing to do so. Anderson v. Burson, 196 Md.App. 457, 9 A.3d 870, 878.

(1997)

REST 3d PROP-MORT § 5.4

END OF DOCUMENT

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

APPENDIX A.9

C

Idaho Law Review
1995

*805 MORTGAGE ELECTRONIC REGISTRATION SYSTEM

Phyllis K. Slesinger [FNa]

Daniel Mclaughlin [FNaa]

Copyright (c) 1995 Idaho Law Review; Phyllis K. Slesinger , Daniel Mclaughlin

TABLE OF CONTENTS

I.	Introduction	805
	A. MERS and the Existing Legal Framework	808
	B. The Existing Environment	809
II.	Development of the MERS Concept	810
III.	Initial Findings	811
	A. Overview	811
	B. Current Situation	812
	C. Estimated Cost Savings from MERS	812
	1. Eliminate the Need for Most Assignments	812
	2. Increased Efficiencies During the Lien Release Process	813
IV.	MERS Organizational Model	813
	A. Clearinghouse Services, Model	813

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

and Structure

B. Industry Response 814

C. Next Steps 815

V. Conclusion 816

VI. Exhibit A: Benefits of the MERS Concept 817

I. INTRODUCTION

Advanced technology has come to the residential mortgage lending industry. [FN1] From applying artificial intelligence and automated ***806** credit scoring, to the mortgage underwriting process, to using electronic data interchange (EDI) to allow appraisers, credit reporting bureaus, title insurers, and others access to the same data, at the same time, to expedite mortgage processing, mortgage lending is being re-engineered to reduce costs and deliver a better product.

Current technology initiatives include the development of not only automated underwriting systems, but also computerized loan origination systems, and various value added networks (VANS) that facilitate "electronic commerce." These initiatives are being developed as proprietary ventures. Another initiative, which promises to have as broad an impact on the mortgage lending industry, is being developed cooperatively. The goal is to virtually eliminate the need for paper mortgage assignments. The tool is the Mortgage Electronic Registration System, or MERS.

The MERS concept calls for the establishment of a central, electronic registry for tracking mortgage rights. [FN2] By using EDI, mortgage sellers, warehouse lenders (interim lenders to mortgage bankers), mortgage investors, document custodians, mortgage servicers, and other participants in the lending industry will be able to obtain, transfer, and identify interests in mortgages essentially on a real time basis. Parties will be able to access the central registry (on a need to know basis), and the registry will be able to communicate with them, even though each may be using proprietary business systems for internal operations.

The registry will be housed in an independent legal entity and will assume the role of mortgagee of record for all registered loans. The concept will require a paper mortgage to be executed and recorded, as is done currently. In addition, it also will require a recorded assignment in favor of MERS, making MERS mortgagee of record. Consistent with mortgage participations where a lead participant ***807** holds legal title on behalf of the other participants, and with secondary market transactions where mortgage servicers hold legal title on behalf of their investors, MERS will serve as mortgagee of record in a nominee capacity only. After registration, all subsequent interests will be established electronically. The rights and obligations of the various users of MERS will be determined by contracts between "trading partners" and the rules of MERS.

Participants in the MERS initiative are the Mortgage Bankers Association of America (MBA), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Government National Mortgage Association (Ginnie Mae), the Federal Housing Administration (FHA), and the Department of Veterans Affairs (VA), which comprise the MERS Steering Committee. Representatives of related trade groups, such as America's

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Community Bankers, the American Bankers Association, the American Land Title Association, the American Bar Association, the American Escrow Association, and others also have engaged in the planning process.

The intent of MERS is to be open. MERS will be available as a utility to all secondary market investors, including conduits and other private mortgage investors, and other interested industry participants, such as portfolio lenders and title and mortgage insurers. Initially, MERS will be targeted at residential mortgages. However, the concept may be applied in the future to multifamily and commercial loans.

MERS is building on the experience of other industries in applying information technology to reduce processing costs. Thirty years ago, stock and bond registration and trading were primarily paper- based. Similar to the use of assignments in transferring mortgage rights, stock and bond certificates were issued to investors to evidence ownership of securities. Each time a security was bought or sold, the original paper certificate was destroyed and a new certificate was issued to the buyer. As trading volumes increased over time, the paperwork became unmanageable, causing delays in trade settlement dates. Because of these problems, the securities industry began to implement book entry systems to streamline the process, eventually reducing costs by over 90 percent.

*808 A. MERS and the Existing Legal Framework

A key premise of MERS is that it will operate within the existing legal framework. [FN3] The establishment of MERS will greatly simplify a terribly cumbersome, paper-intensive, error-prone, and therefore costly process for transferring and tracking mortgage rights. This process is derived from seventeenth century real property law and is not at all suited to late twentieth century mortgage finance transactions. However, the focus is on remedying a particular problem with a scalpel, not a hack saw. Clearinghouse rules will have to be carefully developed to assure the protection of the mortgage rights of participants.

Currently, notes sold into the secondary market are bearer instruments, possession of which under Article III of the Uniform Commercial Code generally determines ownership. Notes and other key documents are held on behalf of investors by third-party document custodians which are approved financial institutions, by mortgage servicers who are financial institutions meeting investor standards for self-custodians, or by the secondary market investors themselves. Custody arrangements are established through contractual agreements, which are generally prescribed by the secondary market investors and give the investors specific rights.

As for mortgages, it is a legal maxim that the mortgage depends on the note for enforceability. Depending on whether a loan is from a "mortgage" or "deed of trust," state and other applicable state law, including recording statutes and case law, an assignment of the security instrument may or may not be necessary to transfer an interest in the particular security instrument and it may or may not have to be recorded. However, the difficulty involved in national investors' staying abreast of state law has resulted in secondary market investors generally requiring recorded assignments for most transfers of prior ownership interests and servicing rights. Warehouse lenders require delivery of a note and an executed but unrecorded assignment of mortgage to perfect their security interest in mortgages. [FN4] A *809 representative scenario of the current environment is detailed below to put the discussion of MERS in better perspective.

B. The Existing Environment

Consider the work of the mortgage lender's attorney today in an environment where mortgage assignments are required to be executed and often recorded to transfer mortgage rights. The lender (Buyer) is acquiring a $550 million port-

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

folio of servicing through a bulk purchase of mortgages with an average loan balance is $125,000. The selling mortgage company (Seller) acquired the mortgages from another mortgage servicer who acquired them from mortgage brokers. The attorney is participating in the due diligence review and must ascertain whether all necessary mortgage assignments were obtained, have been properly prepared, and have been recorded when necessary under the rules of the secondary market agencies.

Sellers' loans were originated through "table funding" transactions. Table funding is a mechanism used in "wholesale" mortgage lending to acquire mortgage servicing rights. Wholesale lenders provide the funds for loan closings and acquire the resulting loans which they sell into the secondary market. Mortgage brokers receive a servicing released premium to compensate them for surrendering the servicing income stream. Pursuant to an interpretation issued by Emerging Issues Task Force of the Federal Accounting Standards Board, a mortgage broker should close the mortgage in its name and record an assignment to the wholesaler in order for the transaction between broker and wholesaler to be considered as a purchase and sale transaction. [FN5]

Because this particular group of mortgages was originated by mortgage brokers and sold to a wholesaler before the servicing was "transferred" (sold) to Seller, the applicable investor guidelines require recorded assignments from the broker to the first wholesaler and from the first wholesaler to the second, our Seller (the first wholesaler sold the mortgages into the secondary market). The current sale of servicing, which is needed for a quick infusion of cash into Seller's business, also will require recorded assignments from Seller to Buyer.

This litany of necessary assignments excludes the unrecorded assignments that were executed and delivered to the commercial banks or other credit facilities which provided funding or the table ***810** funded transactions. As security for their advances, warehouse lenders take possession of the notes and unrecorded assignments in recordable form for the period between loan closing and consummation of the loan's sale into the secondary market. The secondary market investors also require unrecorded assignments when they acquire a loan. When a transfer of servicing occurs, the secondary market investors require that the new servicer provide new unrecorded assignments from it to the investor.

Assuming that the portfolio has 4,400 loans and that recordation is $10 for each loan, the cost of the three recordations alone would be $132,000. This amount does not take into the account the cost of document preparation, the cost of tracking the return of recorded assignments from the recorder's office, the cost of consultants to identify and "clean-up" problems found as a result of a transfer of servicing or merger or acquisition, including but not limited to the cost of re-recording to correct errors. Over the life of a loan, the current environment is very costly to the industry. If Buyer's attorney is not careful, Buyer could be purchasing some expensive headaches.

MERS will also help with the costly lien release function. When loans are paid off, lien releases must be recorded in the public land records. Settlement agents must contact the servicer to obtain the proper payoff amount and ascertain the the servicer currently retains the servicing of the loan. MERS could replace the existing system of mailings and telephone calls with electronic mail.

II. DEVELOPMENT OF THE MERS CONCEPT

In October 1993, the MBA InterAgency Technology Task Force (IAT), comprised of representatives from the MBA, Fannie Mae, Freddie Mac and Ginnie Mae, published a "white paper" at the MBA's Annual Convention [FN6] that describes an electronic book entry system for the residential mortgage industry. The proposed system would be designed not only for use by Fannie Mae, Freddie Mac, and Ginnie Mae, but also by conduits, portfolio lenders, and other mortgage investors.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

The initial goal of the IAT was to develop an understanding of the potential advantages and drawbacks of creating a book entry system. The White Paper used information gathered from industry focus group meetings conducted by the IAT with various participants in the mortgage finance industry. The White Paper presented the concept, *811 identified issues and opportunities, and requested industry guidance in shaping the concept.

The White Paper was used as the primary vehicle for soliciting comments from the real estate finance industry on the MERS concept. Based on the favorable response to the White Paper, a Steering Committee was formed in June 1994, to obtain funding for an independent consultant to validate the assumptions in the White Paper. Ernst & Young, LLP (Ernst & Young) was subsequently engaged to validate the White Paper's findings by conducting a feasibility study and performing other analyses. In its feasibility study, Ernst & Young concluded that the MERS concept is feasible from a business, technical, and cost/benefit perspective. [FN7] Ernst & Young also has prepared a high level technology assessment, and a business process model (a description of the current process of doing business without MERS and a description of what the business process would look like with MERS). Ernst & Young has recently completed a business plan (including recommendations on business structure) and a more detailed cost/benefit analysis.

In performing their tasks, Ernst & Young personnel have conducted numerous telephone and personal interviews. They have surveyed all sectors of the mortgage finance industry, including originators, servicers, warehouse lenders, custodians, assignment processors, staff at Fannie Mae and Freddie Mac, etc. In their role as facilitator at the Westfields Conference, an industry-wide meeting sponsored by the Steering Committee in July, 1994, to present the MERS concept to a broader audience, they elicited many of the factors that will be critical to the success of MERS. To date, they have not identified any major obstacles to implementing the concept.

III. INITIAL FINDINGS

A. Overview

In the short term, a book entry system for the mortgage industry shows tremendous potential to reduce significantly the costs associated with transferring mortgage rights. As initially envisioned, MERS would create a Clearinghouse to track mortgage ownership immediately after loan closing, eliminating the need to manually prepare and record assignments for subsequent transactions, and enabling increased efficiencies in document custody and lien release processing. Preliminary research indicates that MERS could save the *812 industry about $77.9 million [FN8] annually. Most of the savings ($51.7 million) would accrue to mortgage servicers, while $14.1 million would accrue to mortgage originators. [FN9]

In addition to these projected tangible cost savings, MERS will provide clear benefits that are not readily quantifiable today. By establishing a single system for tracking ownership rights, MERS could improve legal notice procedures and fraud detection capabilities, shorten the cycle time necessary to sell loans into the secondary market because of simplified documentation requirements, and provide opportunities for individual companies to re-engineer their internal processes for greater efficiency. The introduction of the universal loan number is likely to contribute significantly in this regard.

B. Current Situation

In 1993, it is estimated that the mortgage industry spent $260 million [FN10] on the following activities to transfer mortgage rights:

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

Preparation, recordation, and management of assignment documents - over its life an average loan has required approximately four unrecorded and two recorded assignment documents.

Movement and recertification of loan files - loan files are moved 83% of the time between closing and investor delivery and 90% of the time during servicing transfers. [FN11]

Lien release process - lien releases require an average of eight separate mailings between parties to release the mortgage lien to the borrower. [FN12]

C. Estimated Cost Savings from MERS

1. Eliminate the Need for Most Assignments

Once MERS is established as the mortgagee of record, all subsequent transfers of ownership would be recorded electronically, eliminating the need to physically prepare, deliver, record, and track assignment documents. The estimated cost savings for assignment processing for a single transfer would be an average of $45.50 per ***813** loan. [FN13]

2. Increased Efficiencies During the Lien Release Process

By providing a centralized location for mortgage ownership information, MERS could eliminate certain mailing costs associated with lien release processing. Currently, when a loan is paid off, paper documents are mailed back and forth between settlement agents, servicers, and document custodians. Participants in MERS could reduce lien release processing costs by at least $2.00 for each loan, by utilizing electronic transmission instead of the mail. [FN14]

IV. MERS ORGANIZATIONAL MODEL

A. Clearinghouse Services, Model and Structure

Existing business entities such as the Depository Trust Corporation (DTC) and the Participants Trust Company (PTC), book entry facilities for the securities industry, provide successful models for establishing a structure for the MERS. That is, MERS would be established as an independent corporate entity, but it would be sponsored by, and operated for, the benefit of its users. Users would share in ownership and management according to their membership status and level of participation. Only slight modifications to the existing process of transferring mortgage rights would be required of users to participate in MERS and take advantage of the greater efficiencies the system could provide.

MERS could potentially have several classifications of participants based upon their roles and the value they would derive from membership. Any group entitled to information on the ownership or servicing of a mortgage could participate in the system. It is likely that some industry groups would simply be suppliers of information or services (e.g. settlement agents, tax services), while others would be customer/users and owner/users.

Direct links with MERS could be established with only a personal computer and modem in conjunction with EDI translation software. Lenders and other participants would use modems or similar devices to communicate with MERS via VANs (public access can be provided through a dial-up phone system).

***814** An integral part of the MERS concept would be the exchange of data between MERS and its members in a standardized format. To facilitate the efficient electronic transmission of data, MERS would establish and implement EDI standards. EDI would enable MERS to transmit data in a common, standardized format. EDI will be a key ingredient

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

to the success of MERS.

Based upon the business plan validated by Ernst & Young, MERS will operate basically as follows. A loan will receive a permanent, universal loan number as early as loan application. Secondary market investors, as well as FHA, and other interested entities will recognize that loan number and eliminate their own loan numbering systems. MERS will become the mortgagee of record for the life of the loan. Consistent with the current process, a paper mortgage will be executed and recorded in the public land records; however, an assignment of the mortgage to MERS also will be recorded. The loan will be registered with MERS upon loan closing, or earlier, depending upon the preference of the originator/ wholesaler.

After registration, the initial document custodian (most likely the document custody facility of the warehouse lender) could hold the mortgage note on behalf of all those having subsequent interests in the loan. Over the life of the mortgage, the various interests and their release will be reflected in MERS via electronic transmissions. Because the mortgagee of record (MERS) would not change while the loan is current, there would be no need either to execute or record in the public land records any assignments to reflect the sale of the mortgage to an investor, the creation or release of the warehouse lender's interest, or the transfer of servicing rights (if a loan is to be foreclosed, MERS either could assign the mortgage back to the servicer or give the document custodian a power of attorney to execute the assignment. [FN15]

If the initial document custodian were retained upon a transfer of servicing, the Agencies would be likely to eliminate the requirement for custodian recertifications. A mortgage banker also would save shipping and recertification costs if it exercises the option of leaving the notes with the first custodian (note immobilization). There would be a tiered fee structure to accommodate low and high volume users, those who merely need to view as opposed to manipulate data, etc.

B. Industry Response

The industry response has been very positive. Mortgage bankers ***815** can see a real benefit in the virtual elimination of paper mortgage assignments. For example, anecdotal research has shown that it could cost up to $250,000 to clean up assignment problems related to a single acquisition of 2,500 loans. A further listing of the benefits that may be derived from MERS is attached as Exhibit A.

An opportunity to hear the reactions pro and con to the concept was presented at the industry-wide Westfields Conference, which brought together the various segments of the mortgage banking industry; interested trade groups, such as the Savings and Community Bankers Association, the American Bankers Association, the American Bar Association, and the National Association of County Recorders and Clerks; the federal financial institution regulators, and others to discuss the concept and its implementation. The meeting had three primary purposes--to make clear that the MERS project was proceeding in an open fashion, to identify operational problems with the concept, and to determine whether these problems could be resolved. To facilitate debate, attendance was limited to representatives of the various sectors of the mortgage banking industry. Selections were made from among the parties who commented on the White Paper or who otherwise demonstrated a real interest in the project. The Steering Committee did make a specific outreach effort to the related trade associations and the financial institution regulators.

Since Westfields, MERS has been discussed at various MBA conferences. Other trade associations, the American Land Title Association, the California and Louisiana Land Title Associations, the Public Securities Association, and the National Association of County Recorders and Clerks have had sessions on the subject at their conventions.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

C. Next Steps

Assuming the decision is made to proceed with MERS, the next phase will involve determining the final technical requirements, obtaining validating legal opinions, and preparing Requests for Proposals (RFPs) from vendors on how to build the technical components that will not be outsourced. The next phase will take the project up to the point of letting the technical and outsourcing contracts. It also will encompass raising the necessary capital for entering into those contracts, whether through loan guarantees, equity, loans from members, or a combination approach. The type of work that would be involved in this phase--marketing to potential participants, determining the technical specifications, developing operational plans and procedures--requires full-time staff.

The questions then become what type of corporate form should the next phase of MERS be housed in and how should it be funded. ***816** According to the Business Plan that Ernst & Young has submitted, MERS should be structured as a cooperative. This structure will facilitate the rebate of the excess of annual income over expenses and is consistent with the approach that MERS would be a utility benefitting the participants.

Ernst & Young projects that it will require $11-12 million to establish MERS. This amount of capital presumes the outsourcing of many standard business functions, such as data processing for payroll and billing, but not the core data services that MERS will provide. The $12 million will include about $3 million to form the cooperative, obtain certain legal research, and contract for the development of Requests for Proposals (RFPs) for various contracts to build MERS (the "Start-Up" Phase). This amount also would include salaries for a president and a few other permanent staff. Ernst & Young projects that the cost of the Development and Implementation Phase would entail close to $6 million. An additional $3 million in working capital would be needed until the corporation reaches the break even point.

Ernst & Young recommends that the implementation phase be funded by a combination of debt and equity. Investors would share on a pro rata basis in the positive cash flow of the corporation. The return to investors could be in the form of reduced or waived fees or cash dividend, as determined by the board of directors. Ernst & Young suggests that the capital expenditures could be phased so that full capitalization would not be needed on Day One of project implementation (the day that contracts are let to develop the necessary systems to operate MERS, etc.).

Actual capital requirements will be determined after final decisions are made on what functions of MERS can be appropriately outsourced and which must be provided by MERS itself.

V. CONCLUSION

The mortgage banking industry is at a crossroads as it attempts not only to automate systems but to re-engineer various processes. MERS is attempting to mesh yesterday's real property law, contemporary mortgage finance transactions, and tomorrow's technology into a system that will benefit the consumer and the many other participants in mortgage loan transactions. Although the organizational tasks may seem daunting, the promised benefits to the industry provide ample incentive to move forward.

***817** VI. Exhibit A: BENEFITS OF THE MERS CONCEPT

A. Elimination of the need for subsequent assignments following the origination and closing of a loan. Clearly, the MERS concept would reduce costs by eliminating the preparation, tracking, shipping and recordation of most mortgage assignments.

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

B. Significant simplification of the loan tracking process. Use of a permanent, universal loan numbering system will allow easy tracking of loans over their life. Large wholesalers in particular will be able to use MERS to track the status of their loans, i.e., closed, received from settlement agents, received by document custodian. If all investors and mortgage insurers and lenders agree to adhere to the same loan numbering system, various reengineering efficiencies also may be achieved.

C. Improvement of the lien release process. The MERS Clearinghouse can be used to facilitate the lien release process which takes on average 10-12 weeks and can take as much as a year or more. Under MERS, servicers can do the necessary due diligence and notify the Clearinghouse (as mortgagee of record) to generate a release document; communications between settlement agents and lenders can be handled via E-mail.

D. Assistance in fraud reduction. The use of the universal loan numbering system and certain other information, such as property address, will provide a cross-referencing capability that will attempt to avoid multiple loan fundings.

E. Simplification of procedures for delivering legal notice by providing an accurate data base of mortgage rights. Currently, the public land records do not necessarily identify the current mortgage servicer, complicating the delivery of legal notices required to be sent to the mortgagee of record, e.g., notice of junior lien foreclosure actions. The Clearinghouse, as the mortgagee of record, will receive the requisite legal notices and will be able to provide an orderly mechanism to assure that servicers and subservicers are informed of pending legal actions.

F. Cost reduction through voluntary note immobilization. Note immobilization will reduce shipping and probably recertification costs. However, note immobilization will not be mandated. The MERS concept, as initially described in the Whole Loan Book Entry White Paper, dated October 1993, entailed actively incenting immobilization through the development of standardized document custodian eligibility requirements or ratings to increase confidence in any particular custodian. It soon became apparent that the approach was raising barriers to acceptance of the MERS concept because of servicer reservations ***818** about interference with existing relationships. Accordingly, the MERS project team decided to delete formal note immobilization incentives from the initial phase of the MERS project. This amends the White Paper analysis but does not affect the feasibility determination.

[FNa]. Senior Director, Secondary Market & Investor Relations, Mortgage Banker's Association of America, Washington D.C.

[FNaa]. Director of Technology Initiatives, Mortgage Banker's Association of America, Washington, D.C.

[FN1]. Residential mortgage lending is generally one of two types--portfolio lending or mortgage banking. Portfolio lenders are financial institutions that basically use deposits to fund mortgage loans that are retained by the institutions for an extended period, or until maturity or liquidation. Mortgage bankers are non- depository institutions, whether independent or owned by a financial institution, insurance company or other business. They use short-term borrowings to fund loan originations. The borrowings are paid off from the proceeds received from selling the mortgages into the secondary market. Mortgage bankers originate or acquire mortgages to obtain fee income for "servicing" the mortgages. Servicing involves: i) collecting borrowers' payments of principal,interest, taxes and insurance; ii) remitting them to the proper payee; and iii) handling mortgage defaults, foreclosures and payoffs.

[FN2]. "Mortgage rights" generally include legal and equitable ownership rights and security interests in mortgages. For mortgages sold into the secondary market, legal title and equitable ownership are commonly severed. Mortgage servicers

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

retain bare legal title to facilitate mortgage servicing; equitable interests are transferred to the investor.

[FN3]. A comprehensive legal analysis of state and federal law will not be completed until the next phase of the project. However, preliminary analysis has not identified any major obstacles, although it is clear that insurance contracts and FHA regulations will have to be revised because they require loss payees to be the mortgagee of record.

[FN4]. See Jan Z. Krasnowiecki, et al., The Kennedy Mortgage Co. Bankruptcy Case: New Light Shed on the Position of Mortgage Warehousing Banks, 56 Am. Bankr. L.J. 325 (1982).

[FN5]. Emerging Issues Task Force, Federal Accounting Standards Board, Issue 92-10 (1992).

[FN6]. Mortgage Banker's Association Interagency Technology Task Force, Whole Loan Book Entry Concept for the Mortgage Finance Industry (Oct. 1993) (hereinafter White Paper).

[FN7]. Ernst & Young, LLP, MERS Cost Benefit Analysis (Dec. 1994) (hereinafter Ernst & Young).

[FN8]. Ernst & Young, supra note 7, at 21.

[FN9]. Ernst & Young, supra note 7, at 22.

[FN10]. White Paper, supra note 6, at I-2.

[FN11]. White Paper, supra note 6, at I-2.

[FN12]. White Paper, supra note 6, at I-2.

[FN13]. Ernst & Young, supra note 7, at 25.

[FN14]. White Paper, supra note 6, at III-7.

[FN15]. Ernst & Young, supra note 7, at 25.
31 Idaho L. Rev. 805

END OF DOCUMENT

© 2011 Thomson Reuters. No Claim to Orig. US Gov. Works.

APPENDIX A.10

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

MICHAEL E. ST. JOHN and ELLEN L. ST. JOHN,

Plaintiffs,

v.

NORTHWEST TRUSTEE SERVICES, INC., et al.,

Defendants.

CASE NO. C11-5382BHS

ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS AND DENYING PLAINTIFFS' CROSS MOTION TO VOID DEFECTIVE FORECLOSURE PROCESS TRISHAND SALE

This matter comes before the Court on Defendants Bank of America ("BOFA") and Mortgage Electronic Registration Systems Inc.'s ("MERS") motion to dismiss (Dkt. 22) and Defendant Northwest Trustee Services, Inc.'s ("NWTS") motion to dismiss (Dkt. 26). Also before the Court is Plaintiffs' (the "St. Johns") cross motion to void defective foreclosure and sale (Dkt. 28). The Court has considered the pleadings filed in support of and in opposition to the motion and the remainder of the file and hereby grants Defendants' motions to dismiss and denies Plaintiffs' cross motion for the reasons stated herein.

I. PROCEDURAL HISTORY

On July 20, 2011, BOFA and MERS jointly filed a motion to dismiss the St. Johns' Complaint against them under Federal Rule of Civil Procedure ("Fed. R. Civ. P.) 12(b)(6) (failure to state a claim). Dkt. 22. On August 10, 2011, the St. Johns opposed the motion. Dkt. 25. On September 9, 2011, BOFA and MERS jointly replied. Dkt. 29.

On August 15, 2011, NWTS moved to dismiss the St. Johns' Complaint against it under Fed. R. Civ. P. 12(b)(6). Dkt. 26. On September 1, 2011, the St. Johns opposed the motion and filed a motion therein to void defective foreclosure process and sale. Dkt. 28. On September 9, 2011, NWTS replied to the St. Johns' opposition to its motion to dismiss. Dkt. 31. On the same day NWTS opposed the St. Johns' motion to void defective foreclosure and sale. Dkt. 30. The St. Johns did not reply.

II. FACTUAL BACKGROUND

This case arises out of the St. Johns' challenge to the foreclosure of their home, which occurred following their home mortgage default. *See generally* Complaint (Dkt. 1). On or about October 26, 2006, the St. Johns obtained a mortgage to finance the acquisition of residential real property in the amount of $385,000 (the "Loan"). Complaint ¶¶ 3, 20. Exhibit B to the Complaint is a copy of the Deed of Trust for this residential property; it identifies the St. Johns as the borrowers, Countrywide Home Loans, Inc. ("Countrywide") as the lender, and MERS as the beneficiary – "as a nominee for Lender and Lender's successors and assigns. *Id.*, Ex. B.

Shortly thereafter, MERS assigned its beneficial interest under the Deed of Trust to BAC Home Loans Servicing, L.P. (now "BANA"). *Id.*, Ex. D. This transfer is

evidenced by record dated December 1, 2009. *Id.* On December 21, 2009, BANA appointed NWTS as the successor trustee under the Deed of Trust. *Id.* Ex. E.

The St. Johns defaulted on their mortgage payements; this fact is uncontroverted. On April 22, 2010, NWTS recorded a Notice of Trustee's Sale on the subject St. Johns' property; the notice referenced the St. Johns' default, arrearages of $62,542.23. *Id.*, Ex. F. The Trustee's sale was set for February 11, 2011. *Id.* To date, the sale is postponed.

On May 18, 2011, the St. Johns filed, and this Court later denied, their motion for temporary restraining order and preliminary injunction. *See, e.g.,* Dkt. 6.

Based on the foregoing, the St. Johns seek declaratory and injunctive relief based on, among other things, the claim that Defendants lack authority to foreclose. *See generally* Complaint.

III. DISCUSSION

A. Applicable Standards

Dismissal under Federal Rule of Civil Procedure 12(b)(6) is appropriate where there is either a "lack of cognizable legal theory" or "the absence of sufficient facts alleged under a cognizable legal theory." *Balisteri v. Pacifica Police Dept.*, 901 F.2d 696, 699 (9th Cir. 1988). In analyzing a Rule 12(b)(6) motion, the Court must construe the complaint in the light most favorable to the plaintiff, accept all well-pleaded factual allegations as true, and determine whether the plaintiff can prove any set of facts to support a claim that would warrant relief. *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337–38 (9th Cir. 1996).

To overcome dismissal, a plaintiff must prove that the complaint complies with Rule 8(a)(2) of the Federal Rules of Civil Procedure by including a "short and plain statement of the claim showing that the pleader is entitled to relief." Additionally,

> [the] complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face" . . . . A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged . . . . [Thus] it asks for more than a sheer possibility that a defendant has acted unlawfully."

Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) (citations omitted) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 556, 570 (2007)). Mere "labels and conclusion" or a "formulaic recitation of the elements of a cause of action will not do." *Iqbal,* 129 S. Ct. at 1949.

"[The Court is] not, however, required to accept as true allegations that contradict exhibits attached to the complaint or matters properly subject to judicial notice, or allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *Daniels-Hall v. National Educ. Ass'n,* 629 F.3d 992, 998 (9th Cir. 2010) (quoting *Manzarek v. St. Paul Fire & Marine Ins. Co.,* 519 F.3d 1025, 1031–32 (9th Cir. 2008)).

B. BOFA & MERS' Motion to Dismiss

BOFA and MERS move to dismiss the St. Johns Complaint for failure to state a claim upon which relief can be granted; their motion is based on the St. Johns'

Complaint, documents attached thereto, and other documents for which this Court could take judicial notice. *See* Dkt. 22 at 3 (relying on Fed. R. Civ. P. 12(b)(6); *id.*, n. 2).[1]

1. MERS Authority to Act as Beneficiary

The St. Johns predicate their request for injunctive and declaratory relief on the theory that MERS lacked authority to act as beneficiary under the Deed of Trust and thus could not assign its beneficial interest. Complaint. ¶¶ 26, 32. Based on this theory, the St. Johns ask the Court to stay the foreclosure proceedings on their residence due to the alleged defective assignment of the beneficial interest in the Deed of Trust.

However, the St. Johns executed a Deed of Trust that names MERS as a beneficiary and therein consented to MERS having such a role in the transaction. *See* Complaint ¶ 20; *id.*, Ex. B (setting out MERS' right to foreclose and sell the property or to transfer such an interest).

The St. Johns' position on this issue is unavailing. This Court has previously and consistently ruled that, when a plaintiff affixes a deed of trust that he/she signed wherein MERS is named as a beneficiary with the right to transfer such rights, the plaintiff's arguments that MERS is not a beneficiary under the security instrument are without merit. *Cebrun v. HSBC Bank USA, N.A.*, 2011 WL 321992 at *3. The St. Johns' case and arguments are not materially distinct from that of *Cebrun*. *See id.*

---

[1] A court may take judicial notice of authentic documents that are publicly recorded, attached to or relied extensively upon in a plaintiff's complaint. *See, e.g., Shaw v. Hahn,* 56 F.3d 903, 908 (9th Cir. 2003); *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003); *Parrino v. FHP, Inc.*, 146 F.3d 669, 707 (9th Cir. 1998).

The Court's ruling in *Cebrun* is not without support from state courts and other district courts within the Ninth Circuit. *See* Dkt. 22 at 6-7 (collecting cases). Therefore, the Court rules the same in this case and rejects the St. Johns' argument on this issue.

2. Recordation of Assignments & Timing of Trustee Appointment

The St. Johns seek declaratory relief as to whether "MERS duly and appropriately executed and/or recorded all endorsements and assignments of the beneficial interest in the Note and Deed of Trust and therefore whether non-judicial foreclosure is allowed by statute." Complaint ¶ 32.

However, Washington State does not require recording of such transfers and assignments. *See* RCW 61.24.005(2) (defining Beneficiary as "the holder of the instrument or document evidencing the obligations secured by the deed of trust"). *See also, e.g., In re United Home Loans*, 71 B.R. 885, 891 (W.D. Wash. 1987), *aff'd* 876 F.2d 897 (9th Cir. 1989) ("assignment of a deed of trust . . . is valid between the parties whether or not the assignment is ever recorded"; "recording of the assignments is for the benefit of third parties).

Additionally, the St. Johns argue that the foreclosure proceeds were invalid because the assignment of the Deed of Trust and appointment of a successor trustee occurred after the issuance of a notice of default in June 2009. However, this claim is unavailing because the notice of foreclosure itself states that the "Beneficiary *or* the Trustee" issued the notice of default, which is consistent with the Deed of Trust Act

under RCW 61.24.030. Thus, the St. Johns have not established any relevance to the fact of timing in this case.[2]

Therefore, the St. Johns' reliance on a lack of recording argument and the timing of assignment of the deed of trust and appointment of a successor trustee are each unavailing.

3. Failure to Disclose Affiliated Business Arrangements

The St. Johns contend that Countrywide "failed to disclose all affiliated business arrangements regarding [the St. Johns'] loan, hence, [the St. Johns] are in doubt and are uncertain as to their [legal] rights . . . ." Complaint ¶ 33. Because Countrywide is not a party to this action and because the St. Johns have not supplied adequate authority that such an uncertainty on their part creates any cause of action herein, the Court denies relief on this basis.

4. Ownership of the Note

In opposing BOFA and MERS' motion to dismiss, the St. Johns make argument regarding the true "note holder" and claim that BANA is not the true "note holder." The St. Johns further contend that "there is not evidence that the note was transferred," and that Defendants are obligated to produce "an unbroken chain of endorsements of the Note." Dkt. 25 at 2.

---

[2] Additionally the notice that the St. Johns' claim was untimely is no longer valid. That notice stated the sale would take place on November 9, 2010, which did not occur. *See* Complaint, Ex. F (notice of trustee's sale); *see also* RCW 61.24.040(6) (notice can only be effective for 120 days). Here, the 120 days has expired and no new notice has been recorded. Therefore, the timeliness argument could also be denied as moot.

However, the undersigned and other courts have routinely rejected this so-called "show me the note" argument. *See, e.g., Freeston v. Bishop, White, & Marshall*, 2010 WL 1186276 (W.D. Wash. 2010); *Wallis v. IndyMac Fed. Bank*, 2010 WL 2342530 at *5 (W.D. Wash. 2010). The St. Johns have not alleged sufficient facts or provided the Court with adequate authority to rule any differently in their case than it has in substantially similar cases presenting the same argument. *See id.*

Therefore, the Court rejects the St. Johns' argument on this issue.

5. TILA & FTC

In opposition to BOFA and MERS' motion to dismiss, the St. Johns argue that they guaranteed a "right of recoupment and setoff pursuant to C.F.R. 16 § 433.2 (Federal Trade Commission ("FTC")), 15 U.S.C. § 1640(e) (Truth in Lending Act, "TILA") without limitation if the loan contract is breached." Dkt. 25 at 5 (underlining in original). Here, the St. Johns have not alleged sufficient facts to invoke these provisions in their case or persuaded the Court that such facts could be alleged to support a claim for such relief.

Therefore, their claims for relief under TILA and the FTC fail.[3]

6. Conclusion

Because the St. Johns have failed to state a claim upon which relief can be granted, they are not entitled to declaratory or injunctive relief for their claims against

---

[3] The St. Johns did not allege in their complaint that BOFA or MERS violated TILA or FTC regulations. Instead such relief is requested within their response in opposition to the motion to dismiss, which is improper. This is another basis upon which the Court could deny relief under TILA and the FTC regulations.

BOFA or MERS. *See, e.g., Marin v. Lowe* 8 F.3d 28 (9th Cir. 1993) (a substantial controversy must exist to warrant declaratory judgment); RCW 61.24.130 (setting out requirements for such injunctive relief in the case of a trustee's sale).[4] Therefore, based on the foregoing, dismissal as to the St. Johns' claims against BOFA and MERS is granted herein.

C. NWTS Motion to Dismiss

The only claim or argument made against NWTS that differs from the St. Johns' arguments against BOFA and MERS is that NWTS is not a valid trustee. However, the St. Johns have not alleged any facts to support this assertion. Therefore, for the reasons stated herein, NWTS' motion to dismiss the St. Johns' claims against it is granted.

D. St. Johns' Cross Motion to Void Defective Foreclosure & Sale

Because the notice of trustee's sale has expired and no new notice has issued, the St. John's cross motion to void foreclosure is denied as moot. An additional basis to deny the cross motion is that the St. Johns have failed to follow the statutory procedure required to challenge the alleged invalid non-judicial foreclosure. *See* RCW 61.24.130 (requiring, among other things, payments to the court clerk of sums that would be due on the obligation secured by the deed of trust).

---

[4] Additionally, even if the Court were to grant injunctive relief, the St. Johns would be required under RCW 61.24.130(a) to make payments owed on the outstanding mortgage debt to the court clerk every 30 days during the period of any injunctive relief. Here, the St. Johns have not made any claims that they are capable of making such payments and the Court is unaware of any such payments to date.

IV. ORDER

Therefore, it is hereby **ORDERED** that:

(1) Defendants' respective motions to dismiss are **GRANTED**;

(2) The St. Johns' motion to void defective foreclosure is **DENIED**; and

(3) The St. Johns' case is **DISMISSED** for the reasons stated herein.

Dated this 29th day of September, 2011.

BENJAMIN H. SETTLE
United States District Judge