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FINANCIAL SERVICES REPORT
Staying Ahead of the Summons

Award Winning Newsletter

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Inside

Editor's Note

Out of respect for the current crisis, we considered skipping our customary flippant intro and going solemn. It was tempting, because we could have capped and traded those virtue points. But as White House Chief of Staff-elect Rahm Emanuel says, "You never want a serious crisis to go to waste."

As we go to press, we are still waiting for an announcement about the pooch. Call us cranky, but we've got a bone to chew. Sure, the President-Elect has been busy selecting his cabinet, but why should it take longer to choose Fido than the Secretary of State? We heard it could be the background checks. No wonder they call it "vet-ting."

Consider what happened to the Dow the day Mr. Obama nominated Timothy Geithner to Treasury. 500 points! That's insane. Even Tim's mother was never that happy to see him. If Mr. Geithner can have that kind of effect, imagine what a real bulldog could do. Of course, some wags say the last thing the new leader of the free world needs is to step deeper into, um, it.

Speaking of such things, we are experiencing a collective version of the Chinese curse, "May you live in interesting times." Only one issue mattered this quarter. We have a lot to report, too much in fact to fit in these pages. But if the number of our Client Alerts is a sign of turbulence, this was a jaw-dropping quarter. More than 20 Alerts, eight one-page "Reference Guides" (a/k/a Cheat Sheets) covering such things as TARP, CaPP, the Emergency Economic Stabilization Act of 2008, Credit Default Swaps, Executive Compensation, Covered Bonds, Money Market Funds, Short Selling Reform, Accounting Rules and Best Practices, Auction Rate Securities, SIVs, Credit Rating Agency Reform, etc. We update these Alerts daily. To stay ahead of the curve, check out http://www.mofo.com.

Is President-Elect Obama at risk of losing the kitty vote over the puppy issue? Someone needs to worry about that. You're welcome.

The first mutt will have big paw prints to fill. The Bush family's Scottish terrier Barney bit a paparazzo in November.

Until next time, have a wonderful New Year. TTYL. ■

William L. Stern, Editor

MoFo Metrics

600	Number of Americans who dressed up as politicians for Halloween, in thousands
5.5	Dollars spent each year on beer by U.S. college students, in billions
20	Calories consumed each day by Michael Phelps, in thousands
6	Percentage of Americans who eat fast food every other day
35	Pounds of French fries consumed by average American, annually
500	Annual revenue from fantasy sports, in millions
12	Laptop computers lost every week at U.S. airports, in thousands
33	Percent of those laptops recovered
30	Millions of dollars in ransom money earned this year by Somali pirates

Beltway Report

If October 2008 were a Spice Girl, it would be Scary Spice. In this section, we try to recap all that's happened in the last three months. But if this sounds too much like "Two-Minute Shakespeare," don't despair. We have issued detailed Client Alerts for all of these Beltway Report items, which we update daily. For more information, go to www.mofo.com.

GRAB A PAIL AND BAIL

Purchase troubled assets? Well, maybe not! Congress passed and the President signed into law the Emergency Economic Stabilization Act of 2008 ("EESA"), otherwise known as the "Bailout" bill. The Act authorizes a troubled asset relief program ("TARP") to be administered by the Secretary of Treasury ("Treasury") in consultation with the FRB, OCC, OTS and HUD. Under the TARP, the Treasury has graduated authority to purchase up to $700 billion in financial institution assets, of which $250 billion will be available for purchases immediately, $100 billion will be available with Presidential certification, and $350 billion will be available for purchases only following a Presidential request and a 15-day waiting period in which Congress may object.

For more information, contact Oliver Ireland at oireland@mofo.com or Barbara Mendelson at bmendelson@mofo.com.

COMMERCIAL PAPER FUNDING FACILITY

On October 7, the FRB announced the creation of the Commercial Paper Funding Facility ("CPFF"), to provide liquidity to term funding markets. The CPFF will provide a liquidity backstop through a special purpose vehicle ("SPV") that will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers. The FRB will provide financing secured by the assets of the SPV and, in the case of non-asset-based commercial paper, by the retention of up-front fees paid by the issuers or by other forms of security. The Treasury will make a special deposit at the FRB of New York in support of this facility. The FRBNY has posted additional information on the CPFF on its website.

COMING TO THEATERS THIS WINTER

Last fall, the federal banking agencies and the FTC issued a new requirement called the "Red Flags Rule" for "creditors" and "financial institutions" to develop and implement an "Identity Theft Prevention Program" to detect, prevent, and mitigate identity theft with respect to certain consumer and commercial accounts. In addition, a new rule from the federal bank agencies and the FTC requires all users of credit reports to confirm a consumer's identity when they receive an address discrepancy notice from a credit reporting agency. This new rule also would require users to furnish corrected address information to credit reporting agencies under certain circumstances. Although businesses might be able to adapt their existing anti-fraud systems to combat identity theft, entities subject to the Red Flags Rule still need to confirm that they have adopted the required written programs. The deadline for compliance with these new rules was November 1.

For more information, contact Barbara Mendelson at bmendelson@mofo.com or Obrea Poindexter at opoindexter@mofo.com.

THE INTERSECTION OF WALL STREET AND MAIN

On November 25, the Treasury and the FRB announced the creation of the Term Asset-Backed Securities Loan Facility. The TALF was created to improve lending to consumers and small businesses by providing liquidity to securities backed by credit card debt, student loans, auto loans, and small business loans guaranteed by the SBA. The Treasury and the FRB noted that the $240 billion annual asset-backed securities market that funds the consumer lending covered by the TALF had essentially come to a halt in October.

For more information, contact Anna Pinedo at apinedo@mofo.com or Any Baumgardner at abaumgardner@mofo.com.

TARP AND CaPP … AND THE IRS

On October 14, the TARP Capital Purchase Program ("CaPP"), through which the Treasury will make capital investments in banking institutions, was announced. The FDIC also announced the Temporary Liquidity Guaranty Program ("TLGP"): a new guarantee program for certain banking institution liabilities. These, together with the expanded CPFF, were structured to unfreeze inter-bank lending and encourage lending more broadly.

The same day, the IRS issued Notices 2008-100 and 2008-101 to provide guidance to banks participating in the CaPP. Notice 2008-100 provides that any shares of stock of a bank acquired by the Treasury pursuant to the CaPP will not cause an ownership change with respect to the Treasury's ownership of the stock of such bank thereby not limiting the bank's ability to utilize prior losses to reduce its taxable income. Notice 2008-101 provides that no amount furnished by the Treasury to a bank pursuant to the TARP shall be treated as "financial assistance" within the meaning of Section 597 of the Internal Revenue Code and therefore will not be considered taxable income to the recipient.

The FDIC later announced a final rule under the FDIC's systemic risk exception process to govern its newly created TLGP. The rule provides further detail on the operation of the TLGP, including that the FDIC guarantee on newly-issued senior unsecured debt will provide timely payment of interest and principal upon the issuing institution's failure to pay and that the guarantee is backed by the full faith and credit of the United States. Several Morrison & Foerster client alerts discuss the TLGP.

For more information, contact Oliver Ireland at oireland@mofo.com or Barbara Mendelson at bmendelson@mofo.com.

GETTING IN LINE FOR MORE REGULATION?

On November 14, the deadline for financial institutions to file an application for CaPP under EESA, four large insurers, Hartford Financial Services Group, Genworth Financial, Lincoln National Corp, and Aegon NV, announced proposed acquisitions of distressed thrifts and filed applications to participate in CaPP. As thrift holding companies, the insurers became eligible to apply for CaPP capital infusions and the FDIC's TLGP, but conversion also subjects them and their non-thrift subsidiaries to regulation by the OTS on top of regulation by state insurance commissioners. It also limits the activities in which they may participate, and constrains their inter-affiliate transactions under the more rigorous banking law regime.

For more information, contact Barbara Mendelson at bmendelson@mofo.com.

TAX LOSS CONTROVERSY

Perhaps the most radical weapon in the government's bailout arsenal is "Notice 2008-83," the Treasury's guidance that lifts the limits on the use of losses by banks following acquisitions. The Notice allows banks greater freedom to use losses under Section 382(h) in mergers and acquisitions. But many in Congress feel it is beyond the Treasury's authority to issue, and two bills have been introduced to overturn the notice. S. 3692 and H.R. 7300 would both overrule Notice 2008-83.

For more information, contact Henry Fields at hfields@mofo.com.

ARE YOU SIGNIFICANT?

In late November, the Treasury Department posted its plan for determining whether an institution is systemically significant and, therefore, worth keeping alive. Unlike the CaPP, there is no application deadline. The factors: (i) the extent to which the failure of an institution could threaten the viability of its creditors and others; (ii) the number and size of financial institutions and the risk of "indirect contagion effects" from the failure of the institution; (iii) whether the institution is important to the nation's financial and economic system such that its failure would cause major disruptions to credit markets or payments and settlement systems; and (iv) the ability of the institution to access alternative sources of capital and liquidity.

For more information, contact Henry Fields at hfields@mofo.com.

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Credit Card Report

Note: We have issued detailed Client Alerts for many of these items. For more information, go to www.mofo.com.

OCC NIXES DISTRESSED CREDIT CARD DEBTOR WORKOUT PROGRAM

On November 10, the OCC denied a request for approval of a new workout program for troubled credit card borrowers allowing them to repay less than the full amount owed while deferring loss recogtnition and income reporting. The OCC does not consider any plan deferring the timely recognition of loss as prudent, particularly for borrowers who cannot even qualify for debt relief programs currently in existence, given its longstanding policy of not allowing banks to attempt long-term recoveries while assets deemed uncollectible have not been accounted for as charge-offs and reported as losses. The OCC cannot approve a plan that defers the timely recognition of losses, which would compromise the transparency and integrity of a bank's financial reports and could lead to a loss of public confidence in the banking system.

The FDIC issued a General Counsel's Opinion declaring that the funds underlying stored-value cards—such as prepaid cards, gift cards, payroll cards, or government benefit cards—are insured deposits as long as they are held by insured depository institutions. Coverage is limited to bank cards and "does not address merchant cards because such cards do not involve the placement of funds at insured depository institutions."

For more information, contact Oliver Ireland at oireland@mofo.com.

FDIC INSURANCE COVERS STORED-VALUE CARDS

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For more information, contact Joe Gabai at jgabai@mofo.com.

BRAVE NEW CREDIT CARD WORLD

In December 2008, just in time for Christmas, the FRB will release the amendments to Regulations AA (Unfair and Deceptive Acts and Practices) and Z (TILA), which will most likely change credit cards as we now know them. Expect the need for major overhauls of all credit card programs, including all disclosures and marketing materials. ■

For more information, contact Rick Fischer at lfischer@mofo.com or Obrea Poindexter, at opoindexter@mofo.com.

Operations Report

Note: We have issued detailed Client Alerts for all of these Operations Report items, which we update daily. For more information, go to www.mofo.com.

NO U-TURN

On November 10, 2008, the Office of Foreign Assets Control ("OFAC") of the U.S. Treasury Department amended the Iranian Transactions Regulations, 31 C.F.R. Part 560 (the "ITR"), to strengthen the U.S. embargo against Iran by prohibiting U.S. financial institutions from engaging in "U-turn" transactions. U-turn transactions are U.S. dollar transactions involving Iran that are cleared through a U.S. bank. This amendment is intended to prohibit transfers designed to "dollarize" transactions through the U.S. financial system for the direct or indirect benefit of Iranian banks or other persons in Iran or the Government of Iran.

For more information, contact Nick Spiliotis at nspiliotis@mofo.com.

RED FLAGS GIVEN CHECKERED FLAG

The FTC announced it will delay until May 1, 2009, enforcement of the Red Flags Rule requiring certain entities subject to FTC regulation to adopt written theft prevention programs. The compliance date was previously November 1, 2008. This delay in enforcement does not extend to the related rules regarding address discrepancies applicable to users of consumer reports or changes of address applicable to card issuers.

For more information, contact Thomas E. Scanlon at tscanlon@mofo.com.

HELLO HELOC

The OTS issued guidance to federal savings associations concerning home equity lines of credit ("HELOCs"). Before curtailing, suspending, or terminating HELOCs, FSAs must ensure compliance with consumer protection laws and regulations such as TILA, ECOA, the Fair Housing Act, and OTS rules regarding nondiscrimination. TILA, for instance, prohibits FSAs from terminating HELOCs and accelerating repayment of the balance except in cases of fraud or material misrepresentation, failure to meet repayment terms, or actions adversely affecting the property. The guidance allows FSAs to freeze or reduce HELOCs when the value of the collateral declines significantly below appraised value, the borrower cannot make payments due to a material change in finances, or the loan is materially in default. FSAs' decision to suspend or reduce HELOCs has to be grounded in sound factual assessments of the value of the property, not necessarily an appraisal.

FSAs must ensure compliance with consumer protection laws and regulations such as TILA, ECOA, the Fair Housing Act, and OTS rules regarding nondiscrimination.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

ATM NOTICE OK

A notice on an ATM machine that consumers "may" be charged a fee upon withdrawing funds and requires them to push "yes" if they want to continue provides sufficient notice of potential fees to comply with the Electronic Funds Transfer Act, the Sixth Circuit held in *Clemmer v. Key Bank Nat'l Assoc.*, 539 F.3d 349 (6th Cir. 2008). The court dismissed a class action filed by an individual asserting he received inadequate notice that he would be charged a $2.00 fee for a cash withdrawal. By providing an on-screen notice that customers "may" be charged to withdraw funds, and then requiring them to press "yes" to proceed, the bank effectively notified customers of its fees. ■

For more information, contact Will Stern at wstern@mofo.com.

Mortgage Report

Note: We have issued detailed Client Alerts for many of these Mortgage Report items, which we update daily. For more information, go to www.mofo.com.

FAIR LENDING AND OPTION ARM LITIGATION

The *NAACP* action has been on a short hiatus due to the failure of Washington Mutual Bank. The first round of motions to dismiss will be heard in early 2009. Meanwhile, on a motion to dismiss in a private party action, the same district judge presiding over the *NAACP* case held that four plaintiffs' claims are time-barred because the allegations of "discretionary pricing policy" do not present a continuing violation. *Kimbrew v. Fremont Reorganization Corp.*, No. 08-3277 AG (C.D. Cal. Nov. 17, 2008).

For Option ARMs, we expect significant developments soon as the frontal challenges to TILA and contract claims, as well as preemption motions, generate court decisions. Due to the Seventh Circuit's *Andrews* decision (discussed next), there has been renewed interest in moving to strike the prayer for TILA classwide rescission.

For more information, contact Michael Agoglia at magoglia@mofo.com.

HURRICANE ANDREWS

As we reported in past newsletters, all eyes were on the Seventh Circuit appeal in *Andrews v. Chevy Chase Bank, FSB*, 240 F.R.D. 612 (E.D. Wis. 2007), which revived the prospect of classwide rescission under TILA, a notion many thought was dead. In September 2008, the Seventh Circuit stuck a fork into that soufflé, concluding, as a matter of law, that TILA does not allow rescission claims to be maintained as a class action. *Andrews* is discussed in a legal update: www.mofo.com/news/updates/files/14528.html.

For more information, contact Michael Agoglia at magoglia@mofo.com or Joe Gabai at jgabai@mofo.com.

RESPA GFE RULE FINALIZED

On November 17, HUD published final revisions to its regulation under RESPA, making with these changes to the original proposal: (i) Eliminating the good faith estimate application, (ii) dropping the proposed requirement for the closing agent to read a script aloud; (iii) shortening the GFE form from four to three pages, and (iv) creating references on the HUD-1 to assist in comparing it with the GFE. The form requires that yield spread premiums to brokers be disclosed either as a "credit" or a as "charge" for the interest rate chosen. The loan originator or broker will be required to guarantee some settlement charges on the GFE, either precisely or (for some) within a 10 percent tolerance. While some provisions of the rule become effective on January 16, 2009, full compliance with the is not mandatory until January 1, 2010. Unfortunately, HUD did not coordinate with the FRB, which is revising its closed-end TILA disclosures, and whose requirements may overlap with the RESPA rule. Stayed tuned to see if the new administration or court challenges block implementation of this new rule.

For more information, contact Joe Gabai at jgabai@mofo.com.

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APPRAISAL GUIDELINES

On November 13, the federal banking agencies issued for comment proposed Interagency Appraisal and Evaluation Guidelines for ensuring that financial institutions' real estate collateral valuations are reliable and support their real estate related transactions. The guidelines respond to heightened concerns over appraisals and credit quality, replace the 1994 Interagency Appraisal and Evaluation Guidelines, and apply to all real estate lending functions within a federal financial institution, including commercial and residential lending departments, capital market groups, and asset securitization and sales units. Comments on the guidelines are due sixty days after publication in the Federal Register.

For more information, contact Oliver Ireland at oireland@mofo.com.

CHEAPER, MORE MORTGAGE LOANS

The FRB announced a $600 billion program to reduce the cost of mortgages and increase their availability. The FRB will buy up to $100 billion in direct debt from Fannie Mae, Freddie Mac and the Federal Home Loan Bank System and purchase another $500 billion of mortgage backed securities from Fannie, Freddie, and Ginnie Mae.

For more information, contact Joe Gabai at jgabai@mofo.com.

REG C REVISIONS

In October 2008, the FRB approved final amendments to Reg C for reporting price information on higher-priced mortgage loans. Instead of requiring lenders to collect and report the spread between the APR on a mortgage loan and the yield on a Treasury security of comparable maturity, the new rule requires lenders to report the spread between the loan's APR and a survey-based estimate of APRs currently offered on prime mortgages of a comparable type. The FRB is seeking to cover subprime mortgages and generally avoid covering prime mortgages, and to conform the threshold for rate spread reporting to the definition of higher-priced mortgage loans adopted under Reg Z in July 2008. The effective date of the rule is October 1, 2009.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

HMDA DATA

In September, the FFIEC released its HMDA data for 2007 on mortgage lending transactions nationwide at 8,610 financial institutions. The data show reductions in lending activity within the overall market and in higher-priced lending. In 2007, loan applications fell 22% from 2006 to 21.4 million. Loan originations dropped by 25% to 10.4 million from the year before. Home loans to higher-risk borrowers fell sharply in 2007, and some riskier practices such as layering "piggyback" mortgages to finance home purchases also decreased.

For more information, contact Joe Gabai at jgabai@mofo.com.

PESKY RESPA

A Seattle district court added to a three-way split on whether Section 8(b) of RESPA prohibits "mark-up" fees. In *Contos v. Wells Fargo Escrow Co., LLC*, 2008 U.S. Dist. LEXIS 88484 (W.D. Wash. Oct. 1, 2008) an escrow company allegedly imposed a $30 fee for a free wire transfer made by the lender. The *Contos* court held that "overcharges" for services rendered by the escrow company were not prohibited, whereas a $30 fee for no actual services by the company stated a claim. In that, the district court aligned with the Second and Third Circuits. But, these appellate courts separately analyzed unilateral charges under Section 8(b) as "overcharges" and "mark-ups." Those Circuits are in line with the Eleventh Circuit's less nuanced view that a single party can violate Section 8(b) by imposing unearned unilateral charges. These three circuits are on the other side of a split with the Seventh, Fourth and Eighth Circuits, where a Section 8(b) violation takes at least two parties and a kickback. ■

For more information, contact Michael Agoglia at magoglia@mofo.com.

Preemption Report

RAH-RAH RALS

The Second Circuit held that a state law regulating tax preparation firms and others who make refund anticipation loans is preempted by the National Bank Act to the extent that it applies to tax-preparation businesses acting as agents of national banks. *Pacific Capital Bank, N.A. v. Connecticut*, 542 F.3d 341 (2d Cir. 2008). Relying on *Watters* and *SPGGC LLC v. Ayotte*, the Second Circuit rejected the state's argument that the statute was not preempted because it regulated the conduct of entities that were not national banks. The relevant inquiry, the court explained, is whether the statute significantly interferes with the national bank's authorized activity, not whether it regulates the national bank directly.

For further information, contact Nancy Thomas at nthomas@mofo.com.

RESPECT THY ELDERS

OTS regulations preempt state-law claims alleging a federal savings bank subsidiary should have prohibited an elderly borrower from using her reverse mortgage proceeds to buy a deferred annuity. *Munoz v. Financial Freedom Senior Funding Corp.*, 573 F. Supp. 2d 1275 (C.D. Cal. 2008). The court explained that common law and consumer protection statutes are preempted by the OTS regulation if, "as applied," they are a type of state law that falls within the illustrative examples in 12 C.F.R. § 560.2(b). Plaintiff's attempt to rely on state law to require a federal savings bank to restrict or monitor a borrower's use of reverse mortgage proceeds implicated one of these examples and was therefore preempted.

For further information, contact Nancy Thomas at nthomas@mofo.com.

OVERDRAFT TROUBLES

A court in San Francisco held that claims challenging a national bank's practices allowing it to maximize the number of overdraft penalties are not preempted by the National Bank Act or OCC regulations. In *Gutierrez v. Wells Fargo Bank, N.A.*, No. C 07-05923, 2008 WL 4279550 (N.D. Cal. Sept. 11, 2008), the court found that these claims only incidentally affected the bank's exercise of its deposit-taking authority because plaintiffs did not challenge the bank's authority to charge overdraft fees. The court also found that the bank had contracted out of preemption for claims challenging the order of debit posting by providing in its customer agreement that it was abiding by unspecified laws governing the account. ■

For further information, contact Nancy Thomas at nthomas@mofo.com.

Privacy Report

ENJOIN WHERE PREEMPTED

Remember SB-1? California's privacy bill (Cal. Fin. Code § 4053(b)(1)) attempted to regulate information-sharing among affiliates, but instead has bounced up and down in the courts ever since its enactment. On October 28, it bounced again. The U.S. District Court in Sacramento entered a permanent injunction. Judge England held that, in accord with *American Bankers Association v. Gould*, 412 F.3d 1081 (9th Cir. 2005) and *American Bankers Association v. Lockyer*, 541 F.3d 1214 (9th Cir. 2008), defendants (state officials all) are permanently enjoined from enforcing section 4053(b)(1) to the extent it is preempted. This is about as cryptic as it gets; a little bit like saying "void where prohibited." Watch for future litigation concerning what types of information are not consumer report information and are therefore subject to the Act's requirements.

You want clarity? Contact Rick Fischer at lfischer@mofo.com.

ID THEFT RULES RULE

The federal banking agencies are gearing up to examine financial institutions for compliance with new identity theft prevention rules. Under the rules, financial institutions and "creditors" must develop written "identity theft prevention programs" that identify relevant patterns, practices, and specific activities that are "red flags" for possible identity theft. The deadline for financial institutions supervised by the banking agencies to adopt their programs was November 1, 2008. By contrast, the FTC recently announced a six-month extension for other financial institutions and creditors, to May 1, 2009. ■

For more information, contact Andrew Smith at asmith@mofo.com.

Arbitration Report

NON-SIGNATORY NON GRATA

The Second Circuit held that American Express could not avail itself of arbitration clauses in plaintiffs' cardholder agreements with entities with which American Express is alleged to have conspired to inflate foreign currency transaction fees. *Ross v. American Express*, 2008 U.S. App. LEXIS 21837 (2d Cir. July 28, 2008). Although the plaintiffs were not American Express credit cardholders, American Express argued that its status as an alleged co-conspirator with the entities that are parties to the cardholder agreements allowed it to enforce the arbitration clauses in those agreements under the doctrine of equitable estoppel. The court disagreed.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

EIGHTH CIRCUIT ON CLASS WAIVERS

In the latest decision addressing the enforceability of class action arbitration waivers, the Eighth Circuit upheld an arbitration provision that contains such a waiver. *Pleasants v. American Express Co.*, 541 F.3d 853 (8th Cir. 2008). The plaintiff sued American Express in a putative class action, alleging a TILA violation. On appeal from an order compelling her to arbitrate on an individual basis, the plaintiff challenged the class action waiver as unconscionable. The Eighth Circuit upheld the waiver, finding it significant that the arbitration clause did not limit the remedies available and that, under TILA, a prevailing plaintiff can recover attorneys' fees, costs, and statutory damages up to $2,000.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

CHOICE OF LAW AND CLASS WAIVERS

Sometimes a choice-of-law provision can save a class action waiver. Sometimes not. In the Ninth Circuit, you might have to flip a coin. In the latest coin toss, the bank lost. *Hoffman v. Citibank, N.A.*, 2008 U.S. App. LEXIS 21680 (9th Cir. Oct. 14, 2008). The plaintiff's card member agreement with Citibank contained a South Dakota choice-of-law clause. The district court held that the class action waiver was not unconscionable under South Dakota law, and granted Citibank's motion to compel arbitration of plaintiff's individual claims. On appeal, the Ninth Circuit remanded because the district court had not considered "whether the enforceability of this class arbitration waiver under South Dakota law is contrary to a fundamental policy of California." *Id.* at *11. The Ninth Circuit strongly suggested that if California law were to apply, the class arbitration waiver would be unenforceable. ■

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Beltway Report

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HOW TO APPEAR SMALL: NEW BHC INVESTMENT RULES

In September, the FRB issued eagerly anticipated guidelines for non-controlling, minority investments in banks and bank holding companies which clarify and liberalize the conditions under which an investor can make a minority investment in a banking organization without being regulated as a bank holding company under the Bank Holding Company Act ("BHCA"). A minority investor is generally permitted to have a single representative on an organization's board of directors without being deemed to exercise controlling influence over that organization, and may even elect two directors of that organization's board provided: (i) board representation is proportionate to the minority investment; (ii) no more than 25% of the board seats are controlled by the minority investor; and (iii) another shareholder, approved by the Board, controls the banking organization. A minority investor will not be seen to exercise controlling influence if: (a) its total equity investment does not exceed one-third of the total equity of the organization; and (b) it does not own 15% or more of any class of voting securities of the organization. Advocacy of changes in management, strategies, policies or decisions in and of itself does not constitute controlling influence as long as decision-making is left to an organization's board, shareholders or management, but control may be implicated if advocacy is linked to explicit or implicit threats to disinvest, sponsor proxy solicitations or take other actions that might coerce a banking organization or its management to take a particular course of action. A Morrison & Foerster legal update further discusses the new policy: www.mofo.com/news/updates/files/14497.html

For more information, contact Barbara Mendelson at bmendelson@mofo.com.

MONEY MARKET INVESTOR FUNDING FACILITY

October was a record-breaking month for acronyms. Our favorite is MMIFF; it sounds like something you might say with a dentist's drill in your mouth.

On October 21, the FRB announced the creation of the Money Market Investor Funding Facility, intended to support a private-sector initiative designed to provide liquidity to U.S. money market investors. Under the MMIFF, the FRBNY will provide senior secured funding to a series of private special purpose vehicles ("PSPVs") to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors. Eligible assets will include certificates of deposit and commercial paper issued by highly rated financial institutions and having remaining maturities of 90 days or less. Eligible investors will include U.S. money market mutual funds and over time may include other U.S. money market investors. It has been reported that the FRBNY is prepared to lend up to $540 billion through the MMIFF and that there will be five PSPVs run by JPMorgan Chase. Another Morrison & Foerster Client Alert explains: www.mofo.com/news/updates/files/081021FederalReserve.pdf

For more information, contact Marco Adelfio at madelfio@mofo.com.

STYLE POINTS

In October, the FRB issued guidance clarifying its programs for consolidated supervision of bank holding companies ("BHCs") and the combined U.S. operations of foreign bank organizations ("FBOs"), and its supervisory expectations with respect to compliance risk management programs and oversight at large banking organizations with complex compliance profiles. Although the drafting of the guidance preceded the current financial crisis, the FRB expects it will support a more resilient financial system. The BHC and FBO guidance is intended to foster consistent FRB supervisory practices and assessments of institutions with similar activities and risks while emphasizing a risk focus and portfolio approach to consolidated supervision. The guidance for large banks with complex compliance profiles endorses the April 2005 Basel Committee on Banking Supervision paper and emphasizes a firm-wide approach to compliance risk management and oversight, independence of compliance staff, robust compliance monitoring and testing mechanisms for identifying compliance risk management weaknesses, and senior management and board of director promotion of effective risk-management programs.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

FDIC ISSUES INSURANCE INCREASES: ONE GOOD, ONE BAD

On October 3, the FDIC issued financial institution letters on the "temporary" increase in the amount of FDIC coverage from $100,000 to $250,000 per depositor. The FDIC advised insured institutions to inform depositors of the coverage increase and its temporary nature. The FDIC also issued a proposed rule that would significantly increase bank deposit premium rates to recapitalize the FDIC's Deposit Insurance Fund, and would make premium rates more sensitive to the risks posed by banking institutions to the fund. The proposal would also change the factors used to determine deposit premiums, which would include excessive use of brokered deposits and secured liabilities. Initially, the proposal would increase the assessment rate categories by 7 basis points (annualized) for the quarter beginning January 1, 2009, while premiums for well-capitalized CAMELS 1- and 2-rated banks would increase to a range of 12-14 basis points from a range of 5-7 basis points. In subsequent quarters, the increase in deposit premiums will be borne by banks posing the greatest risk to the fund.

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TAX TREATMENT—FANNIE MAE AND FREDDIE MAC

The Treasury and the IRS issued Revenue Procedure 2008-64 to provide guidance under Section 301 of the EESA relating to certain indirect investments in the preferred stock of Fannie Mae and Freddie Mac. Section 301 of the EESA provides that any income or loss recognized by banks and certain other financial institutions on the sale or exchange of certain preferred stock of Fannie Mae and Freddie Mac will be treated as ordinary income or loss. The IRS guidance extends this to the sale or exchange of preferred stock held indirectly through certain investment vehicles, such as sales or exchanges by a partnership in which the banks are partners, or through a subsidiary corporation, and applies to transactions occurring after October 29, 2008. In a related development, the federal banking agencies also allowed banks, BHCs, and thrifts having incurred losses on Fannie Mae and Freddie Mac preferred stock to recognize them as ordinary losses for regulatory capital purposes in the third quarter of 2008.

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INTERIM FINAL RULE AMENDING REGULATION D

The Financial Services Regulatory Relief Act of 2006 gave the FRB authority to pay interest on depository institutions' required and excess reserve account balances with the FRB commencing on October 1, 2011, but the EESA accelerated that date to October 1, 2008. Employing the accelerated authority, the FRB announced that it will pay interest on depository institutions' required and excess reserve balances, effective with the reserve maintenance period beginning October 9, 2008. This change was implemented by the issuance of an interim final rule amending Regulation D, "Reserve Requirements of Depository Institutions," which became effective October 9, 2008. Comments on the rule were due by November 21, 2008. The FRB banks will pay interest on required reserve balances, i.e., balances held to satisfy depository institutions' reserve requirements, and on excess balances, i.e., balances held in excess of required reserve balances and clearing balances.

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CAPITAL TREATMENT FOR CaPP STOCK

The FRB adopted an interim final rule allowing BHCs to include in their Tier 1 capital without restriction the senior perpetual preferred stock issued to the Treasury under its CaPP program.

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The rule amends the capital rules included as Appendix A to Reg Y. A 25% limit previously applied to the amount of cumulative perpetual preferred stock that a BHC could include in its Tier 1 capital, and BHCs could not include in Tier 1 capital perpetual preferred stock with a step-up dividend rate. The FRB recognizes that these shares are being issued to increase capital available to banking organizations and include features designed to incentivize issuers to redeem the shares and replace them with private qualifying Tier 1 capital as soon as practicable. The FRB warned that BHCs should not construe this as a detraction from the FRB's longstanding view on the unacceptability of a rate step-up in other regulatory capital instruments. The FRB also expects bank holding companies issuing these shares to hold capital commensurate with the level and nature of the risks to which they are exposed. Although the rule was effective October 17, 2008, the FRB took public comments for 30 days after the rule was published. ■

The FRB warned that BHCs should not construe this as a detraction from the FRB's longstanding view on the unacceptability of a rate step-up in other regulatory capital instruments.

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