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The Common Thread

Harold P. Reichwald

If consumer spending is the engine of our economy and the key to a future economic recovery, recent events suggest that the banking policymakers are seeking ways to jump-start this process. Consider the following:

- The Federal Reserve grants bank holding company status to American Express Company in an accelerated process that gives AMEX immediate access to the borrowing window at the Federal Reserve and possibly CPP capital.
- The Treasury abandons any effort to purchase troubled assets and securities, preferring instead to concentrate during the Administration's waning days on providing capital to banks and other lenders, thereby leaving buyers and sellers who were hoping for some pricing parameters to their own devices in the marketplace.
- The banking regulators jointly issue guidance on what they expect from banks going forward as the primary financial intermediaries, particularly in those consumer sectors which have been frozen out of the market because of the unavailability of securitization funding sources.

The common thread in these seemingly divergent actions is that policymakers at the federal level are extremely worried that growing unavailability or deterioration of credit in the non-residential consumer market holds very significant dangers for the recovery of the overall economy.

American Express

By providing bank holding company status to American Express given the Utah bank that it owns, the Federal Reserve

NEWSLETTER EDITORS

Katerina Hertzog Bohannon
Partner
kbohannon@manatt.com
650.812.1364

Harold P. Reichwald
Partner
hreichwald@manatt.com
310.312.4148

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is on the threshold of inviting a much larger group of players under the Federal Reserve's regulatory umbrella. At the same time, it appears that the Federal Reserve is acknowledging that credit unavailability or deterioration in the consumer sector is a cause for significant concern and that this issue will get worse in the days and months ahead. Thus, direct federal assistance, from the perspective of the Federal Reserve, is justified.

Troubled Assets

Secretary Paulson initially convinced Congress that the EESA bailout plan for purchasing troubled assets was the most efficient way to stabilize the financial system. However, early on he altered course and proposed a Capital Purchase Program for banks and other qualifying financial institutions. The experience of the last month apparently has caused him to abandon any thought of proceeding with the purchase of troubled assets, leaving the marketplace to develop pricing and other parameters on its own without the crutch of federal intervention. TARP funds will not be used to purchase illiquid mortgage-related assets.

At the same time, those institutions receiving early capital infusions were not constrained as to the use to which the new capital could be put, leaving interested observers to wonder if banks would merely sit on the money as a cushion against future developments or use them to acquire other institutions as part of an overall consolidation of the banking market.

In his most recent statements, Secretary Paulson jawboned banks, including those which have not received CPP funds, that they have a special responsibility to make prudent loans and to otherwise restrain the impulse to hoard resources for risk mitigation, dividends or executive compensation.

The New Treasury Emphasis

The Treasury will now concentrate on three major areas: (1) continuing to deploy capital to banks and more importantly, to nonbanks currently excluded from CPP, most likely in conjunction with the infusion of private capital, (2) providing federal financing and liquidity to the securitization market for consumer credit cards, car loans and student loans and (3) developing strategies to deal with mortgage foreclosures. In addition, in a nod to what might be seen as the next credit crisis, Secretary Paulson indicated that the Treasury also is looking at providing assistance to the securitization market for <u>new</u> securitizations of commercial and residential mortgagebacked loans.

Regulatory Initiative

The four regulatory agencies published an Interagency Statement that seeks to promote prudent lending, maintenance of dividend levels which are consistent with an institution's risk profile, capital levels and lending goals and careful oversight of management compensation policies. The agencies stressed that management compensation policies should be aligned with long-term prudential interests and safe and sound banking activities.

Furthermore, with the unavailability of securitization for consumer credit, the agencies want the banks to fulfill their traditional role of being portfolio lenders to this sector.

These newly emphasized concerns will be monitored through the bank examination process, and institutions should be careful to have in place appropriate policies and procedures that reflect these heightened concerns.

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FOR ADDITIONAL INFORMATION ON THIS ISSUE, CONTACT:

Harold P. Reichwald Mr. Reichwald is a highly experienced banking and finance attorney whose career encompasses domestic and international matters for banks and specialty finance institutions. His experience comprises a broad range of matters including: governance matters, sophisticated financial transactions such as asset securitization, LBOs, project finance, corporate lending and restructuring; representation of a variety of domestic and foreign financial institutions before the FDIC, Comptroller of the Currency, the Federal Reserve Board and other bank regulatory agencies in connection with new product development, chartering new banks and branches, issues arising out of the bank examination process and enforcement actions demanded by regulatory authorities.