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MAJOR SHIFT IN LEGACY LOANS PROGRAM

On June 3, 2009, the FDIC formally announced that, although development of the Legacy Loans Program ("LLP") will continue, a previously planned pilot sale of assets by open banks will be postponed. In its announcement, the FDIC indicated that, rather than putting an end to the LLP, it has shifted the focus from use of the LLP for asset sales by open banks to the use of the LLP to dispose of receivership assets of banks taken over by the FDIC.

This development is reminiscent of Resolution Trust Corporation ("RTC") dispositions in the early 1990s. It is worth noting that the basic program outline for the LLP has been drawn from concepts successfully employed by the RTC in structured asset sales in the 1990s, in which the FDIC routinely provided financing assistance.

In furtherance of this program shift, the FDIC expects to test the funding mechanism contemplated by the LLP by soliciting bids for a sale in July of receivership assets utilizing the LLP structure.

Insofar as this FDIC announcement relates to open banks, it largely confirms recent media speculation regarding the LLP. For example, in an article appearing in the Wall Street Journal on May 28, 2009, it was suggested that the LLP is stalling and may be put on hold. What the article did not anticipate is that the LLP would be redirected to dispose of receivership assets.

The key reasons for putting the LLP program on hold as regards open banks include:

(a) The perception held by bank regulators (and many buyers in the market place) that open banks are not particularly motivated to participate in the LLP. There are several reasons for such lack of motivation. Among these are the following:

(i) A recent change in accounting rules has eased accounting treatment for mortgage loans. Such easing creates a disincentive to sell assets during periods of market distress. Indeed, some have argued that the rule changes propagated by the Financial Accounting Standards Board (FASB) have actually created an incentive to banks who have charged off assets in whole, and who can now show "profit" by lowering the projected losses on a "hold to maturity" analysis. Further, a number of banks cannot afford to currently recognize a loss that would result from a present sale of assets at market prices, but are now not required to recognize such loss if they simply hold onto such assets, due to such accounting rule change; and

(ii) Banks' continuing concern that participation in the LLP will subject them to TARP-related restrictions, including executive compensation limits; and

(b) The generally positive results of the "Stress Tests" for financial institutions released by the Federal Reserve in early May, and the notable success of a number of major banks in raising capital to meet capital shortfalls identified through the Stress Tests. These events have greatly reduced the bank regulators' perception that the LLP is critical to the stabilization of open banks. As observed by FDIC Chairman Sheila Bair (and echoed in recent comments by Treasury Secretary Tim Geithner), "Banks have been able to raise capital without having to sell bad assets through the LLP, which reflects renewed investor confidence in our banking system. As a consequence, banks and their supervisors will take additional time to assess the magnitude and timing of troubled assets sales as part of our larger efforts to strengthen the banking sector."

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