

UPDATE

News of Developments in the Financial Sector and Related Areas

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*Venue for Usury Claims Against
National Banks*

In *Beneficial National Bank v. Anderson*, 123 S. Ct. 2058, 2003 U.S. Lexis 4277 (2003), the Supreme Court of the United States held that federal law, i.e., the National Bank Act, preempted state-law claims for usury against national banks. The Court held that there was no such thing as a state-law claim of usury against a national bank. The lawsuit was brought by individual taxpayers who made pledges of their anticipated tax refunds to secure short-term loans from Beneficial National Bank. The individual taxpayers brought suit in an Alabama Court seeking both compensatory and punitive damages on the theory that the bank's interest rates were usurious. The Court noted that the National Bank Act provides an exclusive federal cause of action for usury against national banks and there is no such thing as a state-law claim of usury against a national bank. This decision by the Supreme Court of the United States means that cases involving usury against

national banks must be filed in federal court and not in state court. *Venue* is simply the place where a case should be filed or handled. *Jurisdiction* should not be confused with the term *venue*. *Jurisdiction* has to do with the power of a court to hear and decide a case, whereas *venue* designates the particular court with jurisdiction to hear and determine a case. In the present case, the National Bank Act provided that usury cases against national banks be filed in federal court.

Debt Cancellation Contracts

The dispute over the status of debt cancellation contracts ("DCCs") and debt suspension agreements ("DSAs") issued by national banks in connection with loans to customers has continued to grow. A number of states take the position that DCCs and DSAs are insurance and should be regulated as such. The Office of the Comptroller of the Currency ("OCC") has issued a final rule which became effective June 16, 2003, which confirms the OCC's position that DCCs and DSAs issued by national banks in connection with consumer loans are permissible banking products and not insurance. The final rule issued by the OCC defines a DCC and a DSA as a loan provision or other contractual arrangement under which a bank agrees to cancel or, in the case of a DSA, to suspend all or part of the customer's obligation to repay the bank amounts due under that loan, upon the occurrence of a specified event. The final rule by the OCC establishes safety and soundness standards and consumer protections, such as disclosure requirements in connection with the sale of DCCs and DSAs by national banks.

Payments by Troubled Institutions

The Federal Reserve Board ("FRB") has issued Supervisory Letter SR 03-6 notifying state member banks and bank holding companies that a troubled condition institution (i.e., an institution with a composite rating of 4 or 5, an institution subject to a formal written agreement or an institution which has been notified that it is in a trouble condition) is prohibited from making payments (i.e., golden parachute payments) to officers, directors, employees and controlling shareholders (i.e., an institution-affiliated party) in those circumstances when the payment is contingent on the person's employment, when the payment is on, after or in contemplation that the institution is in a troubled condition and a payment to a person whose employment is terminated under certain conditions. A payment by a troubled institution is only permissible when the FRB and the Federal Deposit Insurance Corporation ("FDIC") approve the payment, the FRB and FDIC approve the hiring of a person including the amount and terms of the payment and the FRB and FDIC approve a reasonable severance payment based on a change of control of the troubled institution.

Accounting for Financial Instruments

The Financial Accounting Standards Board ("FASB") has issued Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*. Previously, an issuing company could account for certain financial instruments as equity. Under the new Statement issued by the FASB, the following instruments will now be classified as liabilities: (i) mandatory redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets; (ii) put options and forward purchase contracts involving instruments that do or may require the issuing company to buy back some of its shares in exchange for cash or other assets; and (iii) obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such

as a market index or varies inversely with the value of the issuing company's shares. For private companies, mandatory redeemable financial instruments are subject to the provisions of the Statement for the fiscal period beginning after December 15, 2003. The Statement is available on the web site of the FASB at www.fasb.org.

Cases, Releases and Rulings

The House Financial Services Committee has approved a proposed bill H.R. 1375 which would give national banks more flexibility in choosing how to incorporate. The Federal Deposit Insurance Corporation recently allowed state banks to form as limited liability companies and the bill would grant the Office of the Comptroller of the Currency the same authority. The bill would make it easier for banks to qualify as Subchapter S status which would make it easier for small banks to be more competitive with credit unions that have a lower tax burden since Subchapter S companies can avoid double taxation. Because all bank directors must be shareholders, some national banks have found it difficult to comply with the limitation that a Subchapter S company have not more than 75 shareholders. The bill would allow directors to hold subordinated debt instead of being a shareholder. The bill would also allow national banks to decide whether or not to allow cumulative voting in the election of directors, which allows shareholders to allocate blocks of votes for individual board candidates. Currently, national banks must have cumulative voting, although most business corporations do not have this requirement.

The North American Securities Administrators Association ("NASAA") has published an *Investment Fraud Awareness Quiz* which is designed to (i) test investors' knowledge of investment fraud, (ii) encourage investors to watch out for warning signs and (iii) help investors avoid becoming a victim of investment fraud. The Awareness Quiz is

available on the web site of NASAA at
www.nasaa.org.