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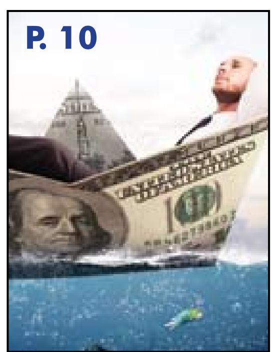

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View from the Chair

by
Rodger Levenson
Executive Vice President
WSFS Bank

Chairman
Delaware Bankers Association

"We are good corporate citizens at a time when Delaware needs us more than ever."

If you've taken even the quickest glance at the local economic news lately you may be discouraged for the First State. In recent years some of the industries that have been prominent in Delaware have disappeared altogether, while others that have been closely identified with the State for over a century have drastically reduced their footprint resulting in personnel layoffs. In light of theses developments the importance of the banking industry to Delaware becomes even more vital.

We in the banking sector have weathered our own storms recently. The memories of the 2008 financial crisis and its residual effects are still fresh in our minds. The key point however is not that there were storms, but that we have weathered them and hopefully emerged stronger from the experience.

I'm sure most of you are great fans of Andrew Jackson. If you're not carrying several pictures of him right now, I'm sure you'd like to be (he's on the twenty dollar bill). Jackson was first a famous general and then the seventh president of the United States. For all his accomplishments, the story is told that his boyhood friends couldn't believe that the Andy Jackson who they grew up with had become such a success. In their estimation he wasn't even the most talented person in their neighborhood.

One of Jackson's friends noted that another pal, named Jim Brown, was not only smarter, but he was a better wrestler. "Why, Jim Brown, who lived right down the pike from Jackson, could throw Andy three times out of four in a wrestling match. But look where Andy is now!"

When it was pointed out that three falls usually decided a wrestling match, the friend admitted that was so. "Sure, that was supposed to be all, but not for Andy. He would never admit he was beat -- he would never stay 'throwed.' Jim Brown would get tired, and on the fourth try Andrew Jackson would throw him and be the winner."

The lesson of course is not how many times we are "throwed" by circumstances, but whether we stay "throwed." It has been rightly noted that success means getting up one more time than you fall.

This is not just important for individuals, but for organizations. I'm pleased to report that our industry continues to be a vehicle for growth in the state. This growth is not just for the benefit of the many who are employed in the banking industry but for the community at large. Delaware has been good for banking, and banking has been good for Delaware. I don't want to be repetitive, but they are facts worth repeating: Delaware's banks contribute to the state with jobs, revenue, investment, contributions, and volunteerism. We are good corporate citizens at a time when Delaware needs us more than ever.

This isn't meant as self-congratulations, but rather an encouragement to do even more. Delaware is a major financial center, both nationally and internationally, but others states and countries are seeing our success and working hard to imitate it. It is our charge as an industry to continue to keep our competitive edge in financial services. Your bankers association remains committed to working with the business sector, as well as with our local, State, and Federally elected officials to be a positive force for the First State. Delaware is depending on us.

Connolly Gallagher Employment Law Group: Timothy M. Holly, Matthew F. Boyer, and Mary I. Akhimien

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President's Report

by
Sarah A. Long
President, CEO & Treasurer
Delaware Bankers Association

"We must strengthen relationships to ensure that Delaware remains the preeminent state for the banking industry."

The financial services industry is alive and well in the State of Delaware! In 1795, who could have imagined that the chartering of the State's first commercial bank, would set into motion a chain of events that would lead Delaware to become nationally known as a leader in the financial services industry.

As one would expect, the new banking industry went through some turbulent times. The first serious crisis occurred between 1811 and 1820 when 195 banks in the country became insolvent. With the crisis looming, a historic meeting of representatives from each of the State's five banks was held in Dover in January 1816 to devise a plan to weather the economic challenge and restore the eroding confidence of the public in the banking industry.[1] Crisis averted.

During the next seventy years, as the industry grew, so did its problems. Eventually the need for a permanent solution could no longer be ignored. In 1887 the Wilmington Clearing House Association was organized to facilitate and regulate the heaviest concentration of banking activities and functions of the city's eight banks.[2]

The success of this association sparked interest in the possible formation of a statewide association with a broader scope of activity. Responding to this interest, the Clearing House issued a call for representatives of all interested Delaware banks to attend a meeting in June 1895 to plan for such an association. The proposal was well received and action swift. A state convention was held in December 1895 in Wilmington at which the Delaware Bankers Association was formally organized with nineteen banks and trust companies pledged to membership.[3]

The Delaware Bankers Association proved to be a stabilizing influence on the largely unregulated local banking industry. Even still, two Delaware bank failures led to the Association working with the Delaware General Assembly to establish the Office of State Bank Commissioner in 1919.[4]

Another sea change occurred in 1981 with the passage of the Financial Center Development Act which created strong economic incentives for banks to be in Delaware.

So what will be the next chapter in Delaware banking history? The State is again facing tough economic challenges and sadly, public confidence in the banking industry has eroded. But we bankers are a hearty bunch. We stand ready to take the lead and chart a course for the future. Just as our predecessors did when they laid the foundation for the financial services industry, we must look again to our member banks to forge and strengthen relationships with our communities, government officials and industry partners to ensure that Delaware remains the preeminent state for the banking industry.

In September 1919, John S. Rossell, then President of the Delaware Bankers Association addressed the membership under similar circumstances: "With the spirit to do our utmost for the attainment of high purposes, and with united and determined effort to secure for Delaware everything that can be had that is best, we can prove ourselves an irresistible force for good. There is nothing too good for Delaware. My ardent hope is that we will all … see before us a prosperous and happy people, enjoying the reward of our own and their labors all the blessings that follow intelligent and industrious endeavor. Let us rededicate ourselves to the service of the State we love so dearly and pledge ourselves one to another that we will direct all our energies to the faithful performance of every duty … and place Delaware – our Delaware – in all things in the front rank among the States of the Union."[5]

Sarah

Sarah (Fellow Historymaker)

Footnotes: 1 - 4 - David Swayze, Esq. and Christine Schlitz, Esq., Digging Into the History Vault, Delaware Banker (Fall 2005).
5 - Annual Report of the Delaware Bankers Association 1919.

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What's New at the DBA

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DBA Supports ABA BankPAC

Delaware Bankers Association Chairman and Executive Vice President & Chief Corporate Development Officer, WSFS Bank, Rodger Levenson presented the DBA's ABA BankPAC contribution to Bethany Hoff, Vice President & Treasurer, BankPAC, at a recent meeting in Wilmington. The DBA is committed to supporting state elected officials, and to ensuring the industry's voice is heard in Washington. Pictured (l to r) Shirley Glanden, DBA Chief Administrative Officer; Rodger Levenson; Bethany Hoff; Sarah Long, DBA President; and, Thomas Collins, DBA Executive Vice President, Government Relations.

DBA Board Meets with Delaware Congressional Delegation

On Monday, November 30th, the Delaware Bankers Association Board of Directors met with Senator Carper, Senator Coons and Congressman Carney along with several of their respective staff members through the hospitality of WSFS Bank. The ninety minute meeting was a free flowing conversation on issues of importance to the financial services industry and Delaware. The Board greatly appreciated this candid occasion to exchange ideas, concerns and opportunities with its entire Washington delegation. Photo (l to r) standing: Thomas M. Forrest, President, U.S. Trust Company of Delaware; Congressman John Carney; James J. Roszkowski, President, Discover Bank; Senator Chris Coons; David M. Hargadon, SVP, Regional Vice President, TD Bank; Mark A. Graham, EVP, Wealth Advisory Services, Wilmington Trust; P. Randolph Taylor, President, Fulton Bank, Delaware Division; Senator Tom Carper; David E. Gillan, Chairman of the Board and CEO, County Bank; Rodger Levenson, Executive Vice President & Chief Corporate Development Officer, WSFS Bank. Seated: Cynthia D.M. Brown, President, Commonwealth Trust Company; Donna G. Mitchell, President & CEO, Deutsche Bank Trust Co. DE; Sarah A. Long, President, Delaware Bankers Association; Elizabeth D. Albano, Chief Financial Officer, Artisans' Bank.

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Cover Story

Rising Tides

In a Rising Rate Environment, Will All Boats Rise?

by
by Mark Evanco and John Foff
FHLBank Pittsburgh

The Turn of the Tide

Years of speculation about when the Federal Reserve might raise interest rates was answered in December when Fed directors voted for a quarter-point increase, the first in nearly a decade. Following this action, the conversation quickly turned to the timing of the next increase and where rates might ultimately settle. While key to economic policy and the economy as a whole, these decisions also matter to individual financial institutions. What do changing rates and the shape of the yield curve mean to their earnings and balance sheets?

The pace at which additional increases occur will have an impact on net interest margins for many financial institutions. Recent statements by Federal Reserve Chair Janet Yellen indicate that "the stance of monetary policy remains accommodative after this increase," implying that additional increases through 2016 may be gradual and only as economic conditions warrant.

Generally speaking, rate hikes and a steeper curve have been positive for financial institutions' earnings. But this time around, there are some caveats. Since competition to add quality assets persists, credit spreads could remain tight, resulting in compressed asset yields. At the same time, retail customers continue to clamor for higher rates on their deposits. It's clear that rate shopping will be the order of the day. Certificates of deposit and money market accounts are beginning to convert to hot money. In short, a rising-rate environment could result in as much margin pressure as a low-rate environment.

Another key consideration in earnings optimization is the shape of the yield curve. Immediately following the Fed's announcement, the curve flattened as the market reaction pointed to a rise in short- and mid-term rates, yet it had little impact on long-term rates. As we move through this new cycle, the question becomes: what shape will the yield curve take?

To navigate these unchartered waters, institutions will need to evaluate potential rate and curve scenarios as they manage their balance sheets. A look back to other Fed rate increases may be instructive.

Of Washes and Wakes

In the past 25 years, there have been only three rate hike cycles, and two of these were quite steep: 1994-1995 and 2004-2006.

Figure One: U.S. Treasury Yield Curve, 1994-1995

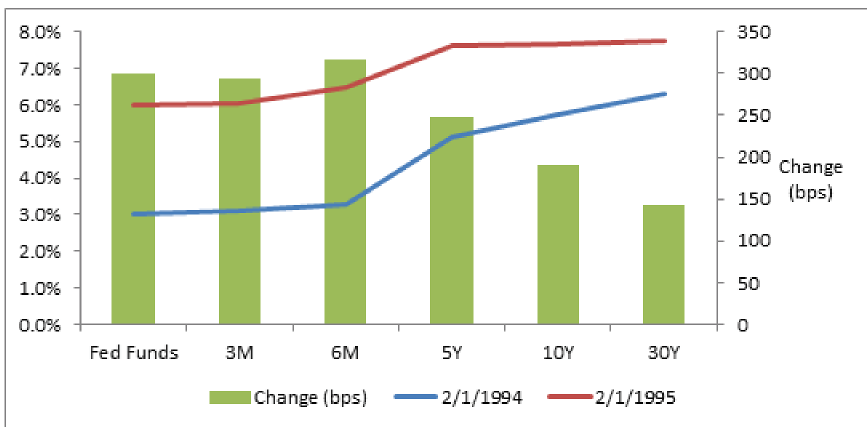
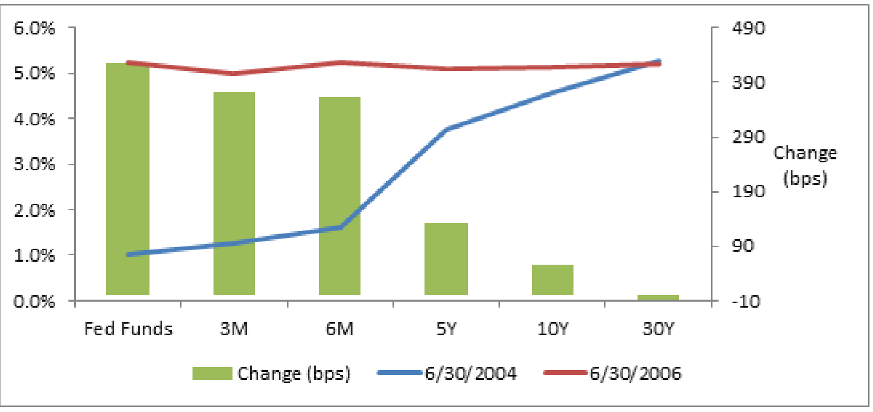


Figure Two: U.S. Treasury Yield Curve, 2004-2006



Source: Bloomberg Finance L.P.

Figure Three: Tightening Cycles

Change in Treasury Rates During Tightening Cycles			
	1994 to 1995	2004 to 2006	Forward Curve (12/31/2016)
5 Year Treasury Note	2.49%	1.33%	0.32%
10 Year Treasury Note	1.91%	0.56%	0.21%

Average Economic Indices During Tightening Cycles			
	1994 to 1995	2004 to 2006	Federal Reserve Longer Run Forecast
Actual Real GDP	4.20%	3.00%	2.00%
Actual Inflation	3.20%	3.40%	2.00%

Source: Bloomberg Finance L.P. and the Federal Reserve Bank, 12/16/15

In the 1994-1995 experience, the target Fed Funds rate doubled from 3.00 percent to 6.00 percent from February 1994 to February 1995 (see Figure One). This increase occurred much more rapidly than anticipated, leaving many financial institutions unprepared to navigate such an environment. Many were short-funded as liabilities repriced much more quickly than assets. This duration mismatch quickly eroded net interest margins and caused long-lasting pain for many financial institutions.

During this same period of time, the curve flattened somewhat. Mid- to long-term rates rose by 2.49 percent in five-year Treasuries and 1.91 percent in 10-year Treasuries (as illustrated in Figure Three). Real Gross Domestic Product (GDP) averaged 4.2 percent, and the Consumer Price Index (CPI) rose by 3.0 percent. This was a period of high growth and high inflation in contrast to today's environment. In 1994, the U.S. economy was on a roll, and the Fed needed to raise rates aggressively to contain inflation.

(continued on p. 12)

Interest Rates

(continued from p. 11)

During the 2004-2006 timeframe, the target Fed Funds rate climbed from 1.00 percent to 5.25 percent (see Figure Two). Different than in the previous decade, this increase occurred over a longer period of time and at a measured and gradual pace. Such a slow and deliberate approach allowed financial institutions more time to adjust their deposit pricing strategies. In some cases, this resulted in teaser-rate wars for money market accounts. However, net interest margins were not hurt as badly since there was plenty of new asset growth taking place. Unfortunately, that growth also included credit quality that was suspect, which contributed to the Great Recession of 2008-2009.

In this time period, the curve flattened as the Fed funds rate rose 4.25 percent while mid- to long-term rates rose by 1.33 percent in five-year Treasuries. This increase was only half as much as 1994-1995. In long-term rates, the 10-year Treasuries rose only 0.56 percent, approximately 30 percent of the previous decade's rate of increase (see Figure Three). Real GDP averaged 3.2 percent, and the CPI climbed 3.4 percent. In the U.S. economy, consumers were taking full advantage of low rates and easy credit. Hindsight being 20/20, the Fed and the economy at large may have been better served by raising rates much more quickly in order to discourage the over-leveraging that occurred in the housing market.

The wash and wake of history is instructive, but it may not help predict the future. Economic, market and regulatory conditions today are dramatically different than before the Great Recession. Despite strong jobs numbers here in the United States, there is still concern that the participation rate in the labor market remains weak with underemployment and sluggish wage growth as additional considerations. A host of other factors come into play that didn't exist in earlier cycles: the fall of Glass-Steagall, the onset of Dodd-Frank, liquidity and capital ratio (LCR) requirements resulting from Basel III, Systemically Important Financial Institutions (SIFIs), China's importance to the global economy and shadow banking, to name a few. Clearly, these are unchartered waters.

For help recasting these two prior tightening periods into today's environment, we can look to the Fed board members' forecasts and the forward curve. Board members of the Federal Reserve issued their "Longer Run" economic predictions on Dec. 16, 2015. These included a Fed Funds target rate of 3.5 percent, a GDP of 2.0 percent and an inflation rate (i.e., Personal Consumption Expenditure Core Price Index) also at 2.0 percent.

Could this longer-run view be our new normal? All of these forecasts are considerably lower than previous rate cycles for growth, inflation and the terminal Fed Funds rate. The Fed indicates that they will approach rate hikes "gingerly" with cautious, incremental upturns. Market consensus takes this to mean a more gradual pace of escalation throughout 2016, perhaps in increments of 25 basis points versus the steeper inclines experienced two decades ago.

An equally important question is: what becomes of longer-term rates? Using the 10-year Treasury as a proxy, the forward-rate curve has 10-year yields at approximately 2.37 percent by the end of 2016 and at 2.00 percent in five years. So, what's a financial institution to do to navigate towards a healthier balance sheet?

Fair Winds and High Tides

FHLBank Pittsburgh can help member financial institutions through products to manage interest rate risk, regardless of the size or pace of interest rate hikes by the Fed or the shape of the yield curve.

As an intermediary between global capital markets and local lenders, FHLBank Pittsburgh provides readily available liquidity, as well as affordable housing and community development opportunities, to member financial institutions of all sizes in Delaware, Pennsylvania and West Virginia.

Institutions believing we are poised to repeat the 1994 cycle, in which all rates rose quickly and significantly, may wish to consider locking in fixed-rate advances and/or selling current, fixed-rate mortgages. Institutions may further reduce duration risk by selling seasoned loan packages. At FHLBank Pittsburgh, we can assist our membership through such advances as well as through the Mortgage Partnership Finance® (MPF®) Program. In addition, institutions may further reduce duration risk by selling seasoned loan packages.

Financial institutions fearing a scenario like 1994-1995, but wanting to buy some optionality in case it doesn't come to fruition, might consider a longer-term, adjustable-rate advance with an interest rate cap. The rate is capped at a preselected level by the financial institution, which is particularly advantageous if rates rise appreciably. However, if rates do not climb according to such a forecast, the financial institution would still only pay the adjustable rate up to the preset cap rate – the net effect is having a traditional floating-rate advance. The option cost is embedded in the rate of the LIBOR-based adjustable advance.

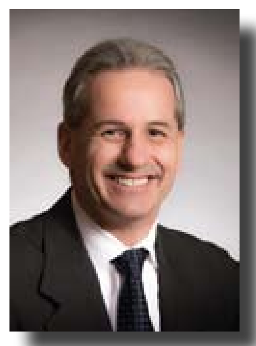
Another option, should forecasts not play out as anticipated, is a fixed-rate advance with a return feature. The return attribute allows the advance to be prepaid on dates predetermined by the financial institution. A key benefit is that no prepayment fees are incurred. For example, a four-year, fixed-rate advance can be selected with a one-time return date of two years. If, in two years, rates rise less than forecasted, the advance can be returned with no prepayment fee on a prearranged date. Again, the cost of that option is added to the advance rate.

On the other hand, if financial institutions believe that this rising-rate environment will look more like 2004-2006 and that long-term rates will not rise significantly, then they may be less inclined to sell longer-duration assets. However, in such an event, the aforementioned advance ideas may still prove to be highly beneficial.

Now that the Fed has begun its march toward a higher Fed Funds rate in 2016, financial institutions will have to chart their responses in order to optimize their earnings. After years of speculation, we

are once again in a rising interest rate environment. For many, this presents opportunities; for others, wariness and caution.

How financial institutions have positioned themselves up to this point is history. How they set their sails for the future depends on each institution's own analysis and strategic decision making. Whatever course you set, you will want to position your risk profile optimally to capitalize on rate and curve changes. To that end, FHLBank Pittsburgh is primed to assist regardless of what interest rate risk cycle may come.



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Recent Developments in Marketplace Lending

Threat for Bankers or Jumpstarting Innovation?

by
Richard P. Eckman
P. J. Hoffman
Pepper Hamilton LLP

The impact of the marketplace lending phenomenon on the banking industry is evolving. While some thought that Lending Club and Prosper's success signaled marketplace lenders as competitors, with the possible consequence of threatening banking's traditional role as a consumer and small business lender, recent developments suggest that collaboration and innovation may prove to a more accurate outcome. Recent partnerships between Regions Bank and Fundera, and JP Morgan Chase with OnDeck show that the banking industry may be starting to embrace the advantages that these fintech lenders have over the traditional banking delivery channels by banks to offer a superior customer experience, greater accessibility, and faster decision making then they could do on their own.

At the same time, the marketplace lending industry has seen a significant uptick in attention from federal banking regulators. Marketplace lenders, or "peer-to-peer lenders" as they are often called, are online platforms that match investors with

borrowers. The marketplace lending industry originated $12 billion in loans of various types in 2014, two platforms (Lending Club and OnDeck) have gone public, and several securitizations of these loans have been packaged and sold. Yet until this year, the industry has remained largely ignored by policymakers and regulators in any systemic way. In the consumer arena, there are a host of federal laws that apply to loans made to consumers, and many states have protections for borrowers, regardless of who the lender is. The state-by-state patchwork of laws and regulations, and application of securities and banking laws designed for other purposes, but applied to marketplace lending, have slowed the evolution of this marketplace more than would otherwise have been possible if the rules had been more carefully and robustly coordinated.

In 2015, we saw two of the major federal banking agencies focus their attention on this industry. First, the U.S. Department of the Treasury ("the Treasury") issued a notice and request ("the Request") for public information concerning the role of marketplace lending in the financial services industry. Second, the Federal Deposit Insurance Corporation ("FDIC") issued Financial Institution Letter FIL-49-2015, warning banks about the risk of purchasing and participating in loans ordinated by non-bank third parties, such as marketplace lenders. Additionally, the recent 2nd Circuit decision in Madden vs. Midland muddied the waters for many is this growing industry.

Treasury Request For Information

The July 16, 2015 Treasury Request bore the hallmark of a preliminary, information-gathering inquiry. The Treasury posed 14 detailed questions to market participants regarding a wide range of topics including: the types of models used by marketplace lenders; the role of electronic data and their risks; how lenders tailor their business models to meet the needs of diverse consumers; whether marketplace lending expands access to credit to underserved markets; the marketing techniques used; the process used to analyze the creditworthiness of borrowers; the relationship between the industry and traditional depository institutions; the role the government could play in effecting positive change in the marketplace lending industry; whether risk retention rules should be applied to marketplace lenders; any harms marketplace lending may pose to consumers; and the secondary market for loan assets originated in the peer-to-peer marketplace.

This request was generally positive in tone and discussed the role that marketplace lenders have played to date in providing access to credit to small businesses and consumers who, in many cases, have faced barriers in accessing credit. Marketplace lenders continue to be able to deliver credit at a lower cost, in a more expedited fashion, and to a more diverse group of borrowers than traditional banks. This was recognized in the question posed by the Treasury what asked how marketplace lenders can continue to meet the needs of consumers who are part of traditionally underserved markets. However, some of the questions posed reflect a complete misunderstanding of how marketplace lenders operate.

By way of background, loans facilitated by marketplace lenders, which often use third-party banks to originate loans to consumers, are subject to a complete framework of federal and state consumer financial protection laws because they are typically originated by regulated financial institutions. Then, investors in marketplace loans typically are investing in securities, thereby providing them with the protection of the U.S. securities laws relating to disclosure and fraud. Additionally, some new investors are investing in marketplace loans through investment funds designed for these specific purposes, which funds are subject to regulation by both the Securities and Exchange Commission and the states.

The Treasury Request received more than 100 comment letters from marketplace lenders, online financial services providers, community banks, credit unions, institutional investors, payment services providers, public interest groups, consumer advocates, trade associations, and others. Such a broad response shows the impact that marketplace lending has had on traditional lending and the disruption that can occur when technology and innovation are combined in an industry ripe for innovation.

FDIC FIL-49-2015

On November 6, 2015, the FDIC issued FIL-49-2015 in an effort to address perceived underwriting and credit risks to FDIC-supervised institutions associated with purchased loans and loan participations from third parties. The letter reminds those institutions of the importance of underwriting and administering purchased credits as if the loans were originated by them. This means that banks are required to perform a complete analysis of collateral and credit risk of each loan or participation and must have a complete understanding of the borrower's market and industry. According to the letter, "this assessment and determination should not be contracted out to a third party." Banks must also conduct an independent analysis and validation of any credit models used by third-party originators. Finally, any third-party arrangements to facilitate the purchase of loans and loan participations must be managed by an effective third-party risk management process.

The FDIC pointed to the specific risks of purchasing and participating in loans originated by non-bank third parties, particularly loans that are unsecured, are made to out-of-territory borrowers, are to borrowers in industries unfamiliar to the bank, or are underwritten using proprietary models that limit the ability of the bank to assess underwriting quality.

The FDIC noted that it has seen several instances where "it is evident that financial institutions have not thoroughly analyzed the potential risks arising from third-party arrangements." As if those requirements were not enough, the FDIC added additional burdens for banks as they are now required to obtain necessary board and committee approvals for purchases of loans or participations in loans, as well as when the banks intend to enter into a third-party arrangement to purchase or participate in loans.

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These changes do not have a specific impact on marketplace platforms that purchase loans from banks that do the origination. Rather the FIL impacts banks that purchase loans from marketplace lenders. However, the banks that are impacted by the FIL will likely have substantial increases in costs imposed, particularly on smaller banks that wish to purchase market place loans. Although the number of loans being purchased by banks that are originated by marketplace lenders is not readily available, it appears that many lenders view loans originated by marketplace lenders as attractive for a number of reasons, including the elimination of origination expenses, the ability to obtain an attractive asset, and the difficulty that banks have in efficiently making smaller loans. These new requirements will undermine the ability of banks to purchase marketplace loans since they now come with increased costs.

The FDIC's FIL is in direct contrast to the mostly supportive Treasury request for information. While Treasury is focused in part on how the federal government can be supportive of innovation in marketplace lending, the FDIC appears to be creating roadblocks to having banks participate in this dynamic and rapidly growing space.

Madden v. Midland Funding, LLC

In a controversial opinion decided on May 22, the U.S. Court of Appeals for the Second Circuit held that the National Bank Act does not preempt the application of state usury laws to third-party, non-bank assignees, in this case a debt buyer. The Court's decision in *Madden v. Midland Funding* — which is inconsistent with long-standing circuit court precedent — complicates interest rate exportation authority for any non-bank party that purchases loans from a bank, including those involved in peer-to-peer or marketplace lending platforms. Third-party, non-bank entities risk losing the exportation advantage that an FDIC-insured bank has and may be subject to substantial penalties, including voiding of loans, for violating a borrower's state usury laws.

In *Madden*, the plaintiff brought a class action against two non-bank defendants for violations of the Fair Debt Collection Practices Act and New York usury law. The plaintiff, a New York resident, opened a credit card account with Bank of America in 2005. The account was subsequently consolidated with the accounts of FIA Card Services, N.A. (FIA), a national bank headquartered in Delaware. Delaware does not have an interest rate cap for banks, so, under the National Bank Act (NBA), 12 U.S.C. § 85, FIA could collect interest at the rate set forth in the terms and conditions provided to the plaintiff, notwithstanding the usury limits in New York. The plaintiff owed a large balance on the credit card account, which was deemed uncollectable, so FIA sold it to the defendants, Midland Funding, LLC and Midland Credit Management, Inc. (collectively, Midland), which are large non-bank debt purchasers. Midland, after purchasing the account, exercised the right granted to it as assignee in the cardholder agreement to increase the interest rate to 27%, which exceeded the 25 percent per annum criminal usury rate in New York.

The U.S. District Court for the Southern District of New York held that the plaintiff's claims were preempted by the NBA, denied class certification and granted summary judgment in favor of the defendants. On appeal, the Court held that the NBA does not preempt state usury laws when loans are assigned to non-bank assignees. Although the Court correctly noted that section 85 of the NBA preempts state law limitations on interest rates, it found that such preemption does not apply when a third-party, non-bank assignee acts on its own behalf (as opposed to on behalf of the originating bank) in assessing interest after the account has been sold to it by the national bank.

The Court distinguished two contrary Eighth Circuit cases, which essentially reflect black letter law that a loan that is valid at inception retains that distinction when assigned to a third party, whether a bank or non-bank. In *Krispin v. May Department Stores Co.*, 218 F.3d 919 (8th Cir. 2000), the Eighth Circuit held that the NBA preempted usury claims against a defendant that purchased accounts from a national bank and emphasized that a court should look to the originating entity and not the third-party assignee when determining whether the loan is valid based on the preemption available to the originating bank. The Court distinguished *Krispin* by explaining that, in *Krispin*, the national bank maintained a substantial interest in the accounts to warrant the application of preemption under the NBA.

In *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2005), the plaintiffs brought an action against a non-bank entity for charging allegedly unlawful fees relating to mortgage loans. The Eighth Circuit held that the court should look to the originating bank to determine whether the NBA applies. The Court distinguished *Phipps* and explained that, in *Phipps*, the national bank charged the allegedly unlawful interest rate while, in *Madden*, the interest rate was charged after the loan was transferred to the defendants. In overturning the district court's decision in *Madden*, the Court explained that, since Midland is neither "a national bank nor a subsidiary or agent of a national bank, or . . . otherwise acting on behalf of a national bank, and because application of the state law on which [the plaintiff's] claims rely would not significantly interfere with any national bank's ability to exercise its powers under the NBA," the NBA did not act to preempt the plaintiff's claims.

The Second Circuit decided not to rehear Madden and the defendants have filed a writ of certiorari to the Supreme Court.

Madden creates a disturbing precedent with respect to whether non-bank assignees can enforce national or state banks' rights under loan agreements and may create a catastrophe, in the secondary lending markets, including securitizations, where loans are sold into a trust or other entity to be held for the benefit of investors who purchase beneficial interests in the pool of loans. Marketplace lenders and investors that purchase interests in loans originated by banks should pay close attention to this case since, if not overturned, could spawn a host of class action lawsuits challenging the rights of holders of such loans to collect interest at the rates made by the originating bank.

What Does This Mean For The Future Of Marketplace Lending?

The marketplace lending industry has seen significant growth through innovation that has benefitted consumers, investors, and the entire financial system over the last few years. Recent partnerships with banks may prove promising for those institutions that want to jumpstart their ability to compete with other marketplace lenders and raise their fintech profile. However, recent attention by government agencies suggests that more scrutiny and possibly additional regulation may impede the growth of this of this industry and may make it more difficult for partnerships to develop. Additionally, the Second Circuit's decision in *Madden* creates uncertainty for some marketplace lending models. Developments in this area happen quickly, perhaps too quickly for federal regulators to keep up with them. Fintech startups continue to challenge traditional bank delivery systems and the Treasury Department's RFI shows the Administration's interest in understanding how marketplace lending works. The danger is that well intentioned regulators, such as the FDIC, will adopt policies that make it more difficult for bank-marketplace lending platforms to develop and flourish. The best the banking industry and the marketplace lending industry can hope for is a "hands off" approach by government to let the free market develop to bring greater efficiencies and access to financial products to the masses.

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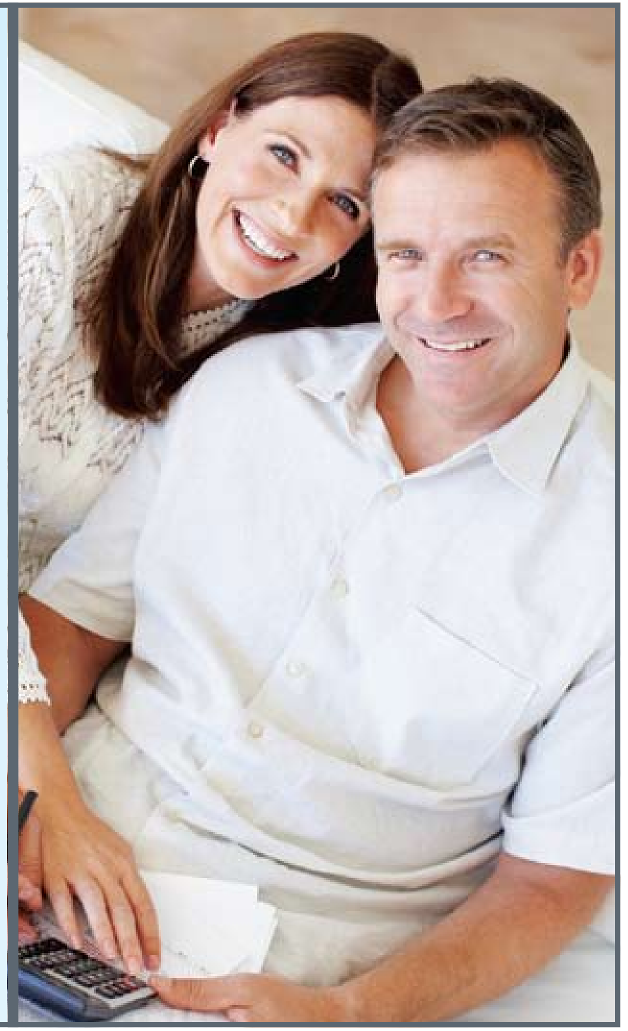
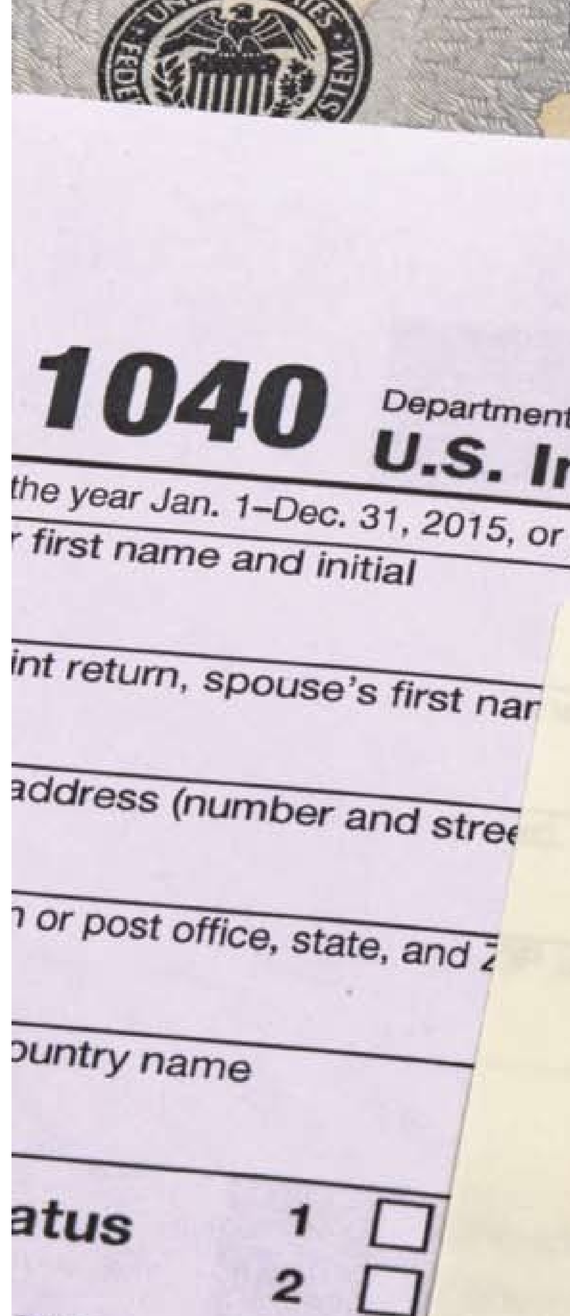


Identity Theft

Don't Think It Can't Happen to You



by Robert Freed
Tax Director/Principal
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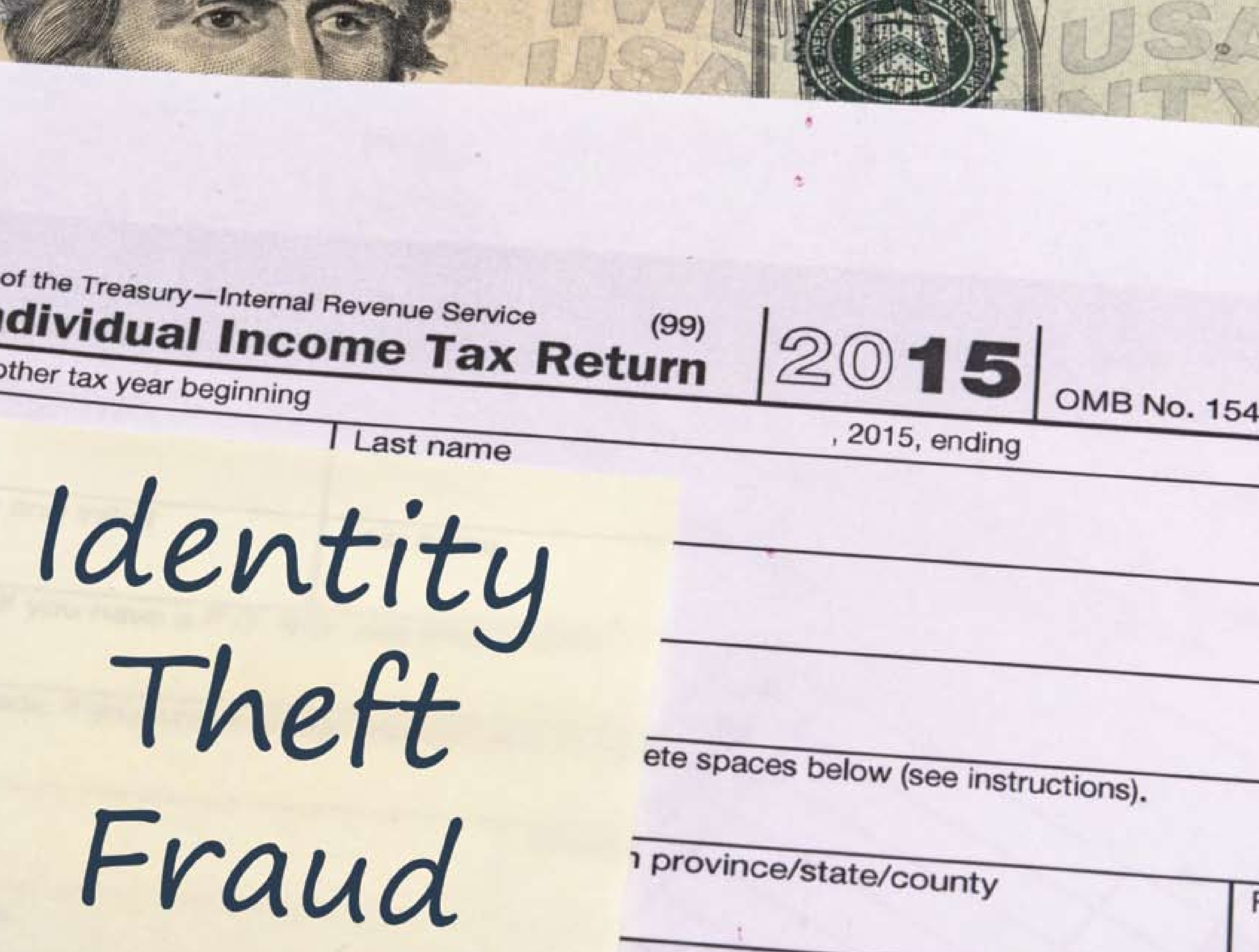
They say there are two things you can't avoid in life: death and taxes. But in today's world, there's a third: identity theft. It's not "if" your identity will get stolen, but "when." What's more, identity theft and taxes often go hand-in-hand; criminals file a tax return in early January using your identity and false documentation to get a tax refund. Then, once you've gathered the proper documents to file your legitimate return in February or later, the IRS tags yours as a duplicate, and your refund bounces. You might not even know your identity was stolen until you get the news from the IRS.

It's nearly impossible to prevent fraudulent tax returns—or any type of identity theft, for that matter. That's because criminals are five steps ahead of us. They're always finding new ways to steal personal information and use it for their gain. They can hack into government agencies. They can intercept a previous tax return. They can retrieve your information from doctors' offices. To file a fraudulent tax return, all they need is your name, date of birth, and Social Security number. It's as easy as I-R-S.

But there's hope. Here's what you need to know about the IRS's latest protective measures, what to do if you're a victim of tax fraud, and other ways to help protect your identity.

The IRS: Stepping up its Game

The IRS recognizes that tax fraud is a big problem, and it's working harder than ever to strike it down. From 2011 through October 2014, the agency stopped 19 million suspicious returns and protected more than $63 billion in fraudulent refunds. In 2014 alone, the IRS also initiated 1,063 identity theft-related investigations, resulting in 748 sentencings. (The average jail time is 43 months; the longest sentencing so far is 27 years.)



In 2015, the IRS says it added even more robust, pre-refund filters to identify suspicious returns. These filters stop most—but not all—fraudulent returns. The IRS also says it continues to expand its partnerships with financial institutions to crack down on this growing crime.

In addition, the agency is now limiting the number of direct deposit refunds to a single financial account or pre-paid debit card (the limit is now three). Any additional valid refunds are mailed to the taxpayer as paper checks. This limit is also stopping any tax preparers who improperly deposit client refunds into their own accounts.

What's more, the IRS is reaching out to victims. While identity thieves steal information from sources outside the tax system, the IRS may be the first to tell you that you're a victim of fraud. Most important is Letter 5071C, which the IRS mails to taxpayers to verify their identity if there's a return filed with a duplicate Social Security number. (In other words, if you receive this letter, someone already filed a return with your information.) Once you verify your identity, the IRS will complete the processing of your return. Expect about six weeks for the IRS to complete the process and issue your (bonafide) refund.

Understand that some IRS cases are extremely tough to resolve, touching on multiple issues and multiple tax years. For instance, fraudulent activity may make it look like you owe more tax, or you received wages from an employer unknown to you. While the IRS is working to streamline its investigation process, a typical complex case can take 120 days to resolve.

You're a Victim. Now What?

If you received the dreaded Letter 5071C, first make sure it's legit. You should receive it only through the U.S. Postal Service; it will be mailed to the address on your tax return. The IRS will never email you, and they won't call you without sending you the letter first. While you won't appreciate getting the letter, you

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Identity Theft

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do need to respond. Otherwise, you won't get your refund, and worse yet, you may be tagged as the scammer.

Letter 5071C gives you two options to confirm whether you filed the return:

- Call the toll-free number provided in the letter. However, if you've ever called the IRS and been on hold for what seemed like eternity, you may prefer the next option.

- Go to www.idverify.irs.gov. It's a secure site and is by far the quickest way to verify your identity. Be aware of scammers directing you to bogus sites ending in ".com," ".org," ".net," or anything other than ".gov."

When verifying your identity, have your prior- and current-year tax returns handy, as well as your W-2, 1099, and other supporting documents. The IRS will ask you questions that only you can answer. Once you verify your identity, you can confirm whether or not you filed the return in question. If you didn't file the return, the IRS will help you with the next steps.

If you've contacted the IRS but didn't get any resolution, you can call the Identity Protection Specialized Unit at 1-800-908-4490.

But Wait. There's More.

While Letter 5071C will help resolve the issue of your tax refund, remember that your identity is still stolen. It can still be used to open fraudulent accounts and lots of other sinister activities you don't want your name attached to. Here are other actions to take right away:

- Complete fillable IRS Form 14039 at IRS.gov. It's an Identity Theft Affidavit to request that the IRS tag your account. The IRS will give you a unique six-digit Identity Protection PIN (IP PIN), which you'll use to prove you're the rightful filer of future federal tax returns. The IRS will send you a new IP PIN each December by mail, and you'll be required to use it in your filings.

Note that the IRS is also offering certain taxpayers—who are unaware they are identity theft victims—the chance to opt into the IP PIN program because their accounts have suspicious activity. If you "qualify," the IRS will mail you a CP01F Notice or another letter inviting you to opt in.

Of course, don't reveal your IP PIN to anyone other than your tax preparer.

- When the IRS mails you any notice, respond promptly. Remember, the IRS will always contact you through the mail.

- Continue to pay your taxes and file your tax returns, even if you must do so by paper.

- File a report with the local police. This is important for two reasons. First, most creditors require a police report to forgive debts caused by fraudulent activity. Second, the police report will boost your credibility with merchants and government officials should you run into future problems with your stolen identity. Most states have laws mandating police departments to file a report. Despite this, some law enforcement officials may try to dissuade you from filing; if this happens, contact your state Attorney General's office.

- File a complaint with the Federal Trade Commission (FTC). Call the FTC Identity Theft Hotline at 1-877-438-4338 or TTY 1-866-653-4261. You can also visit www.ftccomplaintassistant.gov.

- Contact all three major credit bureaus to place a fraud alert on your credit records:
    - o Equifax: 1-800-525-6285, www.equifax.com
    - o Experian: 1-888-397-3742, www.experian.com
    - o TransUnion: 1-800-680-7289, www.transunion.com

- Close out any financial accounts—such as bank and credit card accounts—that appear on your credit reports which aren't yours. Check your credit reports annually.

- Voluntarily freeze your credit. This will prevent scammers from opening new, fraudulent accounts. The freeze can be removed or temporarily lifted, when needed, at your request.

- Check your Social Security earnings statement annually for any strange reporting.

- Understand what type of personal information was stolen.

Was it your name and date of birth? Your credit card number? Your Social Security number? Fortunately, not all data breaches or computer hacks result in tax-related identity theft. If you're the victim of a data breach, reach out to the company in question and ask what they're doing to protect you.

Minimize Your Risk

Even if you haven't (yet) been the victim of identity theft—tax-related or not—you can take steps to help protect yourself:

• File your tax returns electronically if you can. When you file your return by mail—in an envelope clearly addressed to the IRS during tax season—it's being touched by many hands at the U.S. Postal Service. It takes just one set of hands to compromise your mail. Instead, opt for the IRS's e-file program, the safest way to file. (It's also the quickest.) IRS e-file meets strict security guidelines with secure encryption technology to protect your tax return. The IRS has processed more than 1.3 billion e-filed tax returns from individuals since the program began.

• If you file electronically yourself, use a secure Internet connection. It may seem luxurious to file your return while sipping an espresso macchiato and using shared Wi-Fi at Starbucks, but anyone can tap in and access your information. (For that matter, never process personal information, including credit card numbers, on a shared Wi-Fi.)

• Shred any draft copies of your tax returns or calculation sheets you no longer need.

• Before hiring a tax preparer, do your research. Ask for recommendations from friends. Remember that you're entrusting your tax preparer with a lot of confidential information.

• Keep your Social Security card in a safe deposit box at your bank. Carrying it in your wallet or purse is asking for trouble.

• Don't give your Social Security number to a business — or medical facility—just because they ask. They really don't need your number.

• Protect your personal information in your home. Make sure your computer is password protected and has firewalls and anti-virus software. Don't leave bank statements lying on your desk. Think of where you can safely store your information should your home ever be broken into.

• Get in the habit of changing your passwords, and don't use the same password for everything. Also, use strong passwords. Strong passwords are usually eight characters or longer, do not contain a real name or complete word, and contain a combination of uppercase letters, lowercase letters, numbers, and keyboard symbols.

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- Never give your personal information over the phone, unless you initiated the call or know the person on the other line. Unfortunately, this also applies to organizations calling you for a charitable donation; some are frauds. When you do get a call from a charity, ask them to send you a packet of information. If they follow through, they are most likely the real deal.
- Consider subscribing to a service such as LifeLock, which helps protect your identity through fraud detection and identity restoration. Personally, I subscribe to LifeLock; it offers much peace of mind.

Indeed, there are three things we can't avoid in today's world—death, taxes, and identity theft. Hopefully someday, death and taxes will be our only worries. Till that day comes, get smart. If you're a victim of identity theft or a fraudulent tax return, take immediate steps to reduce the damage. And whether you're a victim or not, minimize your risk. Finally, educate yourself. The IRS offers plenty of resources at www.irs.gov/identitytheft for information on warning signs and other identity protection tips. You get just one identity. Protect it like your life depends on it.

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"The Affordable Care Act created burdensome new reporting requirements under IRC Sections 6055 and 6056"

Affordable Care Act Updates for 2016

The New Year always brings change and opportunity. Why should the ACA be any different? From additional guidance and clarification to delays and repeals, the ACA (Affordable Care Act) continues to evolve and manifest new compliance concerns. Let's highlight some of the major developments.

ACA Reporting Deadlines Delayed

The Affordable Care Act (ACA) created burdensome new reporting requirements under IRC Sections 6055 and 6056. Under these new reporting rules, Applicable Large Employers (ALE's) must provide information to the IRS and to their employees about the health plan coverage they offer (or do not offer) using forms 1094 and 1095. The reporting is intended to close the loop with respect to employer health plan coverage and costs and the information needed by the government to administer ACA mandates such as the large employer shared responsibility penalty and the individual mandate.

On Dec. 28, 2015, the IRS issued **Notice 2016-4** to delay the due dates for filing and furnishing forms 1094 and 1095 under Section 6055 and 6056.

- The due date for furnishing forms to individuals has been extended from Feb. 1, 2016, to **March 31, 2016**.
- The due date for filing forms with the IRS has been extended from Feb. 29, 2016, to **May 31, 2016** (or, from March 31, 2016, to **June 30, 2016**, if filing electronically).
- Employees will not be required to amend their returns to include their 1095's received after filing their taxes.

Cadillac Tax Delayed and Others Suspended

The ACA imposes a 40 percent excise tax on high-cost group health coverage, also known as the "Cadillac Tax" which was originally slated to go into effect in 2013 then delayed to 2018. This tax is intended to encourage companies to choose lower-cost health plans for their employees, but also to raise revenue to fund other ACA provisions.

On Dec. 18, 2015, the President signed a federal budget bill for 2016 into law, which delays implementation of the Cadillac Tax for two years, until 2020, removes a provision prohibiting the Cadillac Tax from being deducted as a business expense; and requires a study to be conducted on the age and gender adjustment to the annual limit.

This budget bill also imposes a one-year moratorium on the collection of the ACA's health insurance provider fee, for 2017; and imposes a two-year moratorium on the ACA's medical device excise tax, for 2016 and 2017.

ACA Penalties and Affordability Percentage Increase

On Dec. 16, 2015, IRS issued **Notice 2015-87** which increased the shared responsibility penalties, clarifies and updates the application of the affordability percentage to the affordability safe harbors, addresses health reimbursement arrangements (HRAs) and employer payment plans (group health plans under which an employer pays for an employee's individual health insurance premiums).

Tax Guidance on Same Sex Marriage

On Dec. 9, 2015, the IRS issued **Notice 2015-86** to address how the Supreme Court's *Obergefell* ruling—which declared same-sex marriage legal in all 50 states—impacts employee benefit plans.

According to the IRS, employees in same-sex marriages should be treated the same as employees in opposite-sex marriages for federal tax purposes, including employee health benefits.

Automatic Enrollment Repealed

On Nov. 2, 2015, the President signed into law the Bipartisan Budget Act of 2015, which includes a provision repealing the ACA's automatic enrollment requirement.

ACA Repeal

On January 8, 2016, President Obama officially vetoed the reconciliation package to repeal major components of the ACA. The bill was passed by the House of Representatives on Wednesday, January 6, amended and passed by the Senate in December, the 62nd such vote but the first time that the bill made it to President's desk. A veto override vote is not expected to be successful.

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Compliance Focus

Your AML Risk Management Program Must Remain at the Top of Your List of Priorities

by
Christopher Price, CAMS, AMLP
Assistant Director,
Center of Regulatory Intelligence
FIS Risk, Information Security
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"Mismanagement of the risks of money laundering and terrorist financing can carry severe penalties from U.S. regulatory authorities."

Last June the U.S. Treasury published The National Money Laundering Risk Assessment (NMLRA) for the first time since 2005 and an initial National Terrorist Financing Risk Assessment (NTFRA). The NMLRA and the NTFRA are based upon an analysis of 5,000 law enforcement cases, U.S. financial institution suspicious activity reporting and information garnered from various regulatory and law enforcement agencies. The NMLRA and the NTFRA, in addition to recent Anti-Money Laundering (AML) regulatory enforcement actions, provide new and actionable intelligence that every single financial institution must know and translate into risk mitigation to avoid negative material impact to earnings, capital and reputation.

As if these risks are not enough, mismanagement of the risks of money laundering and terrorist financing can carry severe penalties from U.S. regulatory authorities. Harsh punishment can result from actions that facilitate (knowingly or unknowingly) money laundering, terrorist financing, or other financial crimes. This includes failure to have an adequate AML risk management program in place.

Penalties for an institution can include:

- Monetary penalties
- Enforcement actions
- Rejection of applications for growth (e.g., mergers, acquisitions, interstate branching, etc.)
- Termination of the institution's deposit insurance and charter (i.e. "death penalty")

Enforcement actions often lead to extensive costs related to remediation, including hiring independent third parties to assist with repairing the areas of noncompliance. Lookback reviews are frequently required. These are costly, time consuming, and increase an institution's risk exposure and cause reputational damage.

The NMLRA highlights a number of criminal strategies that are new variations on old practices. Each financial institution must ensure that the AML risk management program is recalibrated to cover these evolving schemes to detect and report suspicious activity namely Interstate Funnel Accounts, Trade –Based Money Laundering (TBML), Money Brokers and TBML, Nominees and Misuse of Legal Entities, Front Companies, Shell Companies and Shelf Companies.
The NMLRA also identifies several other evolving schemes that are variations of old money laundering techniques that financial institutions should closely re-assess to ensure detection and reporting of suspicious activity relating to misuse of inherently high-risk products, services and client relationships such as:

- Correspondent banking services
- Remote deposit capture
- Prepaid cards
- Third party payment processors relationships
- Virtual currencies, such as Bitcoin, dealers
- Mortgage loan originator fraud
- Auto dealer relationship fraud

The NMLRA identifies the following areas in which financial institutions can reinforce their compliance programs:

- Leadership actively supports and understands compliance efforts;
- Efforts to manage and mitigate AML deficiencies and risks are not compromised by revenue interests;
- Relevant information from the various departments within the organization is shared with compliance staff to further AML efforts;
- Adequate resources are devoted to compliance functions;
- The compliance program is effective by, among other things, ensuring that it is tested by an independent and competent party; and,
- Leadership and staff understand the purpose of the institution's AML efforts and how its reporting is used.

The NMLRA also reminds financial institutions to ensure compliance with certain

state-specific laws and regulations in the U.S. There are twelve states with AML laws and regulations.

The NTFRA identifies specific risks and vulnerabilities of which institutions should be aware when developing and implementing AML risk management programs, including:

- Use of the charitable sector to transmit licit funds for illicit ends
- Social media networks used to solicit funding from U.S. sources under the guise of charitable giving
- Correspondent banking relationships with foreign financial institutions
- Complicit or willfully blind MSB operatives, who also may bank with U.S. depository institutions
- Cash smuggling across U.S. borders
- Use of commercial enterprises in the U.S. to funnel funds to terrorist organizations
    - o These enterprises will usually require a business relationship with a U.S. depository institution, thus exposing that institution to terrorist funding.
    - o Cigarette smuggling remains a popular mechanism for funding terrorist activities, rendering cigarette wholesalers and retailers high-risk entity types for financial institution customer bases.
- Fraud in the form of extortion
    - o U.S. entities targeted for extortion may be manipulated into payments through cash, wires and checks that are processed through U.S. financial institutions. Such entities may have one or more foreign operations that make them vulnerable to extortion.
    - o This brings to bear the importance of geographical risk factors in assessing customer-specific money laundering and terrorist financing risks, as well as Know Your Customer's Customer (KYCC) Due Diligence.

In order to effectively mitigate the risks and vulnerabilities described in the NMLRA, NTFRA and analysis of regulatory enforcement action trends, every financial institution must re-calibrate its AML risk management program and focus on the Four Pillars of a BSA/AML Management Program, which are:

- AML Policies, Procedures and Internal Controls
- Designation of a Board-appointed BSA/AML Compliance Officer
- Training
- Independent Testing of the AML Program

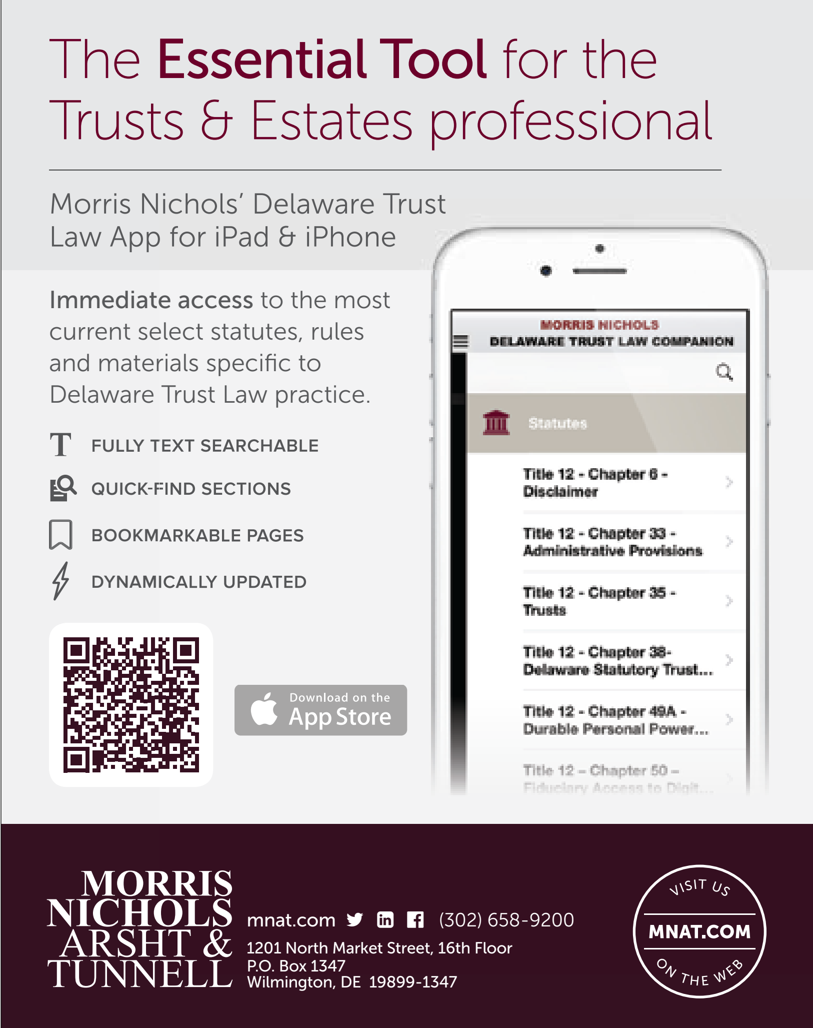
Finally, the NMLRA and the NTFRA reports contain critical intelligence and warning signals for every single financial institution. The following are three action steps from the NMLRA and NTFRA reports each financial institution should take in order to immediately mitigate the emerging risks and stay proactive:

1. Review closely the latest emerging money laundering schemes in the NMLRA, such as Interstate Funnel Accounts, Money Brokers and TBML, Nominees and Misuse of Legal Entities, and re-calibrate your AML risk management program to ensure detection and reporting of suspicious activities relating to the evolving schemes.

2. Closely review the latest terrorism financing schemes and trends in the NTFRA, such as increased misuse of charitable organizations for fund raising or conduit for terrorism financing, and re-calibrate your AML risk management program to ensure detection and reporting of suspicious activities timely and effectively.

3. Perform a situation analysis to assess applicability and status of compliance with the twelve states with specific AML laws and regulations based on your institution's scope of operations. Do not dismiss inapplicability; instead perform careful analysis based on all products, services, customer relationships, operations, etc. and implement compliance procedures as necessary. Be sure to report the analysis to the board of directors to ensure proper discharge of their fiduciary responsibilities.

This column was excerpted from FIS' Regulatory Intelligence Briefing (RIB) – U.S. Department of the Treasury's National Money Laundering Risk Assessment and National Terrorist Financing Risk Assessment, August 12, 2015. *To read the full RIB, please go to: http://www.fisglobal.com/Insights/RISC.*



DBA Calendar of Events

For more information on these and other programs visit **www.debankers.com**, or phone the DBA at 302-678-8600, or email: debankers@debankers.com

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March 2016

March 2nd - 4th – 2016 DBA Executive Officer Visit to Washington, DC. This highly acclaimed event for top-level bank executives provides an extraordinary opportunity to meet with the key federal regulators as well as with our industry's representatives at the American Bankers Association in Washington, DC. In addition, we also meet with the entire Delaware Congressional Delegation. This year, DBA participants will be staying at The Mayflower Hotel located at 1127 Connecticut Ave NW, Washington, DC 20036. Sponsorship opportunities are available.

April 2016

April 25th through 29th - 2016 Teach Children to Save Week. Join other Delaware volunteer bankers as they visit public, private, and parochial schools, throughout the state as part of Delaware's 18th annual Teach Children to Save Day. Banker volunteer registration starts February 15th at www.debankers.com. This year's lesson will teach the way that individual saving impacts the whole community. The lesson is taken from the new book, *The Great Investo and Money Tree*. The book, the sixth in the series, was written and illustrated by Greg Koseluk and made possible by a grant from Capital One 360.

May 2016

May 12th – The 121th DBA Annual Meeting and Dinner. Hotel du Pont, Wilmington. Join Delaware's top bankers at this annual event at the historic Hotel du Pont with dinner in the elegant Gold Ballroom. Guest Speaker: Katty Kay, Journalist, Lead Anchor, BBC World News America. Sponsorship opportunities are available.

October 2016

October 25th & 26th – 2016 Delaware Trust Conference. Chase Center on the Riverfront, Wilmington, DE. Save the Date Now! You won't want to miss the eleventh annual edition of this premiere trust event that hightlights the advantages of the Delaware Trust product. Join dozens of expert panelists from the trust, legal, and accounting fields to learn the latest Delaware Exclusive information. Sponsorships and exhibitor spaces are available.

Web and CD Seminars

For more information, or to register, please visit the Web Seminar link at www.debankers.com. The DBA has introduced an improved web seminar catalog featuring an easy to view, searchable listing. There is no log-in required to view the catalog. The checkout function has also been improved and includes itemized receipts.

February - March 2016

February 9 - Recognizing Elder Fraud for Staff

February 10 - Loan Documentation 101 - Part 1: Basic Secured Loan Documentation

February 11 - Call Report Lending Schedules, Part I

February 11 - Incident Response: Practical Procedures to Ensure You Will Fail Well

February 16 - Revised Ability to Repay/Qualified Mortgage Options

February 17 - Loan Documentation 101 - Part 2: Lien Perfection: Business Collateral

February 19 - Financial Analysis Toolkit Part I: Personal Financial Statement Analysis

February 23 - Loan Documentation 101 - Part 3: Reviewing Collateral Files

February 23 - Completing the Currency Transaction Report

February 24 - 7 Habits of Highly Successful Supervisors

February 25 - 4 Steps to a Practical Business Continuity Plan in an IT World

February 26 - Opening Deposit Accounts for High Risk Customers: CIP, CDD & Risk

February 29 - Financial Analysis Toolkit Part II: Introduction to Personal & Business Tax Returns

March 1 - TRID: Six-Month Checkup

March 2- Basics of Real Estate Loan Documentation

March 4 - Call Report Revisions & Update, Part II

March 7 - Analyzing Business Financial Statements

March 8 - Regulation E Demystified

New

5:30am - 9:00am

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Lending Law Update

by
Brent C. Shaffer, Esq.
Young Conaway Stargatt & Taylor, LLP

"The five pitfalls mentioned here and other lien risks can be minimized by careful closing diligence and documentation."

Top Five Ways Banks Can Lose Mortgage Lien Priority

Commercial real estate lending is underwritten on the value of, and cash flow from, the financed property, making the enforceability and priority of the mortgage paramount. Here are five common situations in which banks can end up with mortgages that are impaired or with lien priority that is less than expected:

1. Erroneous Property Description. An incorrect metes and bounds description used in a mortgage can result in liens on adjacent properties overlapping with the mortgage and the inability to foreclose the mortgage because it does not encumber only a subdivided, conveyable parcel. Typical errors include keying errors that result in a description without an enclosed parcel or not matching the survey, and descriptions being taken from old deeds that do not match revised record plats.

2. Hidden Pre-Existing Rights. Pre-existing purchase options and rights of first offer can be buried in leases or management agreements, leading to rights that can impair the ability to foreclose. It is essential to not only carefully review title reports for these rights, but also obtain estoppel certificates from commercial property tenants regarding the absence of these rights.

3. Statutory Liens and Assessments. Banks have always had to live with "super priority" tax liens for periods after loan closing that prime existing mortgages. These super lien rights now extend beyond basic real estate and school taxes, to assessments for special improvement districts (such as Wilmington's Business Improvement District), community association assessments (which have priority over first and second mortgages to the extent of assessments for a six month period under the Delaware Uniform Common Interest Ownership Act), and assessments imposed to repay loans made for renewable energy improvement costs under Property Assessed Clean Energy (PACE) programs.

4. Lack of Power and Authority. If a business entity's or trust's organizational documents do not provide proper power and authority to obtain a mortgage loan, the mortgage lien can be void. It is essential to review the borrower's documents and resolutions to determine that obtaining the loan for the purpose at hand is in the borrower's power, that the borrower can and has authorized the loan, and that the person signing the mortgage has the authority to do so.

5. Lack of Consideration and Fraudulent Transfers. If the real estate securing the loan is owned by a guarantor, the lack of a sufficient nexus between the guarantor and the borrower can result in an unenforceable mortgage due to no benefit given to the guarantor; and if reasonably equivalent value is not provided to the guarantor for the mortgage, the mortgage can be set aside as a fraudulent transfer under the United States Bankruptcy Code and Delaware Uniform Fraudulent Transfer Act.

There are many other ways that banks can lose mortgage lien priority. Fortunately, the five pitfalls mentioned here and other lien risks can be minimized by careful closing diligence and documentation.

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