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LAW CLERK

COPY VOL. 6 of 8

IN THE

SUPREME COURT

OF THE

STATE OF IDAHO

Citibank (South Dakota) N.A.

Plaintiff and Respondent

VS.

Miriam G. Carroll

Defendant and Appellant

Appealed from the District Court of the Second *Judicial District for the State of Idaho, in and for* Idaho *County*

Hon. John Bradbury *District Judge*

Pro Se

Attorney for Appellant

Sheila R. Schwager

Attorney for Respondent

Filed this ______ *day of* ______, *20*___

______ *Clerk*

By ______ *Deputy*

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IN THE DISTRICT COURT OF THE SECOND JUDICIAL DISTRICT

OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF IDAHO

CITIBANK (SOUTH DAKOTA), N.A., Plaintiff/Counterdefendant,	)	**Case No. CV 2006 37067**
v.	)	**CITIBANK'S SUPPLEMENTAL REPLY BRIEF IN SUPPORT OF SUMMARY JUDGMENT**
MIRIAM G. CARROLL, Defendant/Counterclaimant.	)	

Plaintiff, Citibank (South Dakota), N.A. ("Citibank"), by and through its attorneys of record, Hawley Troxell Ennis & Hawley LLP, hereby submits this Supplemental Reply Brief in Support of its Motion for Summary Judgment on the Complaint filed against Defendant Miriam G. Carroll ("Defendant"), with an attached Appendix.[1]

I. INTRODUCTION

Defendant's Supplemental Opposition, filed on June 28, 2007 ("Opp."), fails to establish that the ICAA applies to Citibank in this simple credit card collection case. Instead, as established in Citibank's Supplemental Brief, the ICAA does not apply to Citibank.

[1] Unless otherwise noted, terms are used herein as defined in Citibank's Supplemental Brief in Support of Motion for Summary Judgment, filed on May 29, 2007 ("Supplemental Brief").

<u>First</u>, there is no dispute that Citibank is a national bank organized under the laws of the United States. As a national bank, Citibank is a "regulated lender" and is therefore exempt from the ICAA. In fact, as confirmed in the concurrently-filed Affidavit of Michael Larsen, Bureau Chief of the Consumer Finance Bureau of the Idaho Department of Finance, the Idaho Department of Finance "does not license national banks under the ICAA whether they are collecting their own debts or the debts of third parties because national banks are regulated lenders as defined at Idaho Code § 28-41-301(37) and are therefore exempt from the application of the ICAA, pursuant to I.C. § 26-2239(2)." (Affidavit of Michael Larsen ("Larsen Aff."), ¶ 4.) Moreover, Defendant's unsubstantiated contention that Citibank is not a "regulated lender" because it purportedly engages in *ultra vires* activity by securitizing its credit card receivables and servicing the credit card accounts is completely unavailing. The OCC expressly authorizes the securitization of credit card receivables as a permissible activity for a national bank, and Citibank is well within its powers under the National Bank Act when it securitizes its credit card receivables and also acts as the "servicer" for such receivables. Accordingly, the ICAA simply does not apply to Citibank.

<u>Second</u>, Defendant cannot credibly dispute that Citibank is collecting on the Account, which it owns, for its own benefit. Defendant's arguments regarding the Master Trust and the ownership of the credit card receivables in the Master Trust have nothing to do with the collection of this Account by Citibank. The fact that the receivables relating to the Account may have been removed from the Master Trust when the Account was charged-off does not change the fact that Defendant's debt, and the corresponding obligation to repay such debt, is owed to Citibank, and not to the Master Trust, trustee or third-party investors.

<u>Third</u>, even if the Court were to accept Defendant's skewed and inaccurate analysis that Citibank is collecting on behalf of the Master Trust, Citibank has amply demonstrated that both the Issuance Trust and Master Trust are under common ownership and control with Citibank

such that Citibank, as well as the Trusts, are exempt from the ICAA pursuant to I.C. § 26-2239(10).

Defendant's arguments simply lack substance. The pertinent facts have been, and continue to be, straightforward and simple: Defendant entered into a credit card agreement with Citibank; Defendant agreed to pay for all transactions made on the Account; Defendant used, and incurred charges, on the Account; and Defendant failed to pay the Account. The fact that Citibank uses its assets (i.e., its credit card receivables) as an investment vehicle does not alter Defendant's agreement to honor her debt to Citibank. After minimal probing, it is clear that Defendant's arguments simply serve to muddle up the true facts in an attempt to avoid liability for the Account that Defendant agreed to pay.

II. ARGUMENT

A. Citibank Is National Bank And Is Therefore Completely Exempt From The ICAA As A Regulated Lender.

As established in the Supplemental Brief and herein, Citibank is exempt from the ICAA because it is a national bank and, therefore, a "regulated lender." Idaho Code § 26-2239 states that "[t]he provision of this chapter shall not apply to . . . (2) Any regulated lender as defined in section 28-41-301(37) . . . ."

The Larsen Affidavit confirms the plain language of I.C. §§ 26-2239(2) and 28-41-301(37): "The Department of Finance does not license national banks under the ICAA whether they are collecting their own debts or the debts of third parties because national banks are regulated lenders as defined at Idaho Code § 28-41-301(37) and are therefore exempt from the application of the ICAA, pursuant to I.C. § 26-2239(2)." (Larsen Aff., ¶ 4.) Importantly, the Idaho Supreme Court previously has relied upon the interpretation of the ICAA by the Idaho Department of Finance in determining the appropriate scope of the ICAA. See Davis v. Professional Bus. Servs., Inc., 109 Idaho 810, 712 P.2d 511, 517 (1985) (relying on amicus brief of the Idaho Department of Finance). This Court should grant the same deference here.

There is no dispute that Citibank is a national bank organized under the laws of South Dakota and the United States. The National Bank Act grants Citibank the powers of, among other things, "receiving deposits" and "loaning money" (see 12 U.S.C. § 24 (Seventh)), and the OCC regulates Citibank's banking activities. See Supplemental Brief at 4; Order Taking Judicial Notice (Feb. 1, 2007); see also Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735, 737-38, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996) (recognizing that Citibank's home state is South Dakota); OCC Interpretive Letter No. 452 (Apr. 11, 1989), 8 No. 1 OCC Q.J. 77, 1989 WL 451256, at *1 (confirming that Citibank's home state is South Dakota).[2] Indeed, Defendant concedes that the OCC has exclusive regulatory authority here because, in support of her Opposition, she submits a section of the OCC-published Comptroller's Handbook entitled *Activities Permissible for a National Bank.* (See Affidavit of David F. Capps ("Capps Aff."), Exh. A.)

Tellingly, Defendant does not, and cannot, offer any authority supporting her contention that the ICAA applies to a national bank, like Citibank. Instead, Defendant contends (again without any authority) that Citibank is not a "regulated lender" because Citibank ceases to be a national bank when it securitizes its credit card receivables and, therefore, purportedly engages in *ultra vires* activity by servicing credit card accounts. Not only is this argument illogical, it clearly is wrong. As discussed below, the OCC specifically authorizes the securitization of credit card receivables as a permissible activity for national banks. In fact, the same OCC handbook relied upon by Defendant specifically states: "National banks may securitize and sell assets they hold, including mortgage and nonmortgage loans that are originated by the bank or purchased from others." See Capps Aff., Exh. A at 32.

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[2] This Supplemental Reply Brief contains the Westlaw citations for four Interpretive Letters and one Corporate Decision authored by the Office of the Comptroller of the Currency. Attached to this brief is an Appendix that contains hard copies of each of these five cited OCC documents, plus Exhibits A & B.

1. **The OCC, Which Has Exclusive Regulatory Authority Over National Banks, Specifically Authorizes The Securitization Of Credit Card Receivables As A Permissible Activity For A National Bank And Part Of The Business Of Banking.**

The National Bank Act confers broad powers upon national banks, including "all such incidental powers as shall be necessary to carry on the business of banking," and further including, without limitation, the powers of "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt." 12 U.S.C. § 24 (Seventh). It is undisputed that the OCC is tasked with the exclusive authority to regulate the national banking system. See 12 U.S.C. § 93a; Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1564 (2007) ("As the agency charged by Congress with supervision of the NBA, OCC oversees the operations of national banks and their interactions with customers."). The OCC "exercises visitorial powers, including the authority to audit the bank's books and records, largely to the exclusion of other governmental entities, state or federal." Watters, 127 S. Ct. at 1564. State-court litigation that would "prevent or significantly interfere with the national bank's exercise of its powers" is preempted by the United States Constitution's Supremacy Clause, Article VI, cl. 2. Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 33 (1996); accord Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 314-15 (1978); Watters, 127 S. Ct. at 1566-67 ("In the years since the NBA's enactment, we have repeatedly made clear that federal control shields national banking from unduly burdensome and duplicative state regulation.").

As the agency "charged with supervision of the National Bank Act," the OCC's regulations have the force of federal law, and in the absence of express federal statutory language to the contrary, are binding on this Court. See NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co., 513, U.S. 251, 256; see also 12 U.S.C. § 93a (broad grant of rulemaking power to OCC); Smiley v. Citibank (S.D.), N.A., 11 Cal. 4th 138, 156 (1995), aff'd, 517 U.S. 735 (1996).

The OCC also is the appropriate regulator with respect to the debt collection programs and activities of national banks. See OCC Interpretive Letter, 1985 WL 151323, at ¶ 4 (Aug. 27, 1985) ("[I]t is both usual and necessary for banks to undertake collection activities with respect to their own delinquent loans."); see also NationsBank of N.C., 513 U.S. at 258 n.2 (defining the "business of banking" and national banks' "incidental powers" broadly); Burgos v. Citibank, N.A., 432 F.3d 46, 49 (1st Cir. 2005) (collection activity engaged in by a national bank "is simply 'part and parcel' of a customary banking activity").

Importantly, the OCC has determined that the powers conferred under the National Bank Act include the "broad authority to buy and sell loan assets" and "broad authority to borrow money and to pledge their assets as collateral for such borrowings" (OCC Interpretive Letter No. 540, 1991 WL 570780, at * 2 (June 1991) (citations omitted)), and "[e]stablishing credit card accounts and generating accounts receivable evidencing extensions of credit." OCC Corporate Decision No. 98-39, 1998 WL 667884, at *4 (Mar. 27, 1998) (approving securitization of credit card receivables by Citibank, N.A. through subsidiary). Specifically, the OCC authorizes the securitization of credit card receivables by permitting national banks to sell credit card receivables and use them as collateral for an investment security:

> Credit card receivables are loan assets evidencing loans made on personal security. [Citations]. National banks may purchase and sell these loan assets pursuant to their authority to discount and negotiate evidences of debt. Indeed, the United States Supreme Court has long recognized that the negotiation, i.e., the sale, of evidences of debt acquired through a national bank's express authority to lend money on the security of real estate is authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). See First National Bank of Hartford v. City of Hartford, 273 U.S. 548 (1927). Similarly, as the OCC stated in Interpretive Letter No. 416, the negotiation of loans made on personal security is also part of the business of banking. Accordingly, the Bank is authorized to sell its credit card receivables through use of the Subsidiary. In addition, because national banks are authorized to borrow money and to pledge their assets as collateral therefore, the Subsidiary is authorized to borrow funds in the market using the credit card receivables as collateral.
>
> The use of securitization to accomplish the sale of the receivables or as a vehicle for borrowing against them is a permissible means by which a national bank may carry out these activities. As the OCC has previously noted, securitization is simply a means for effecting the selling, purchasing, borrowing

and lending functions of the secondary market. [Citation]. Through use of the various securitization structures, banks are able to sell and borrow against their assets in this market more efficiently.

OCC Interpretive Letter No. 540, 1991 WL 570780, at * 3 (approving transaction in which national bank subsidiary would sell bank's credit card receivables to trust, bank would continue to service all receivables through affiliate and subsidiary would cause trust to issue participation certificates to investors); see OCC Corporate Decision, 1998 WL 667884, at *4 (approving the securitization of credit card receivables "as part of the business of banking" and a "permissible activity for a national bank").

In furtherance of its exclusive regulatory authority over national banks, the OCC issues a detailed Comptroller's Handbook -- essentially a compendium of bank policies, procedures and guidelines -- regarding the examination of the commercial activities of national banks, including, without limitation, asset securitization and the risks and advantages involved in asset securitization.[3] Importantly, the OCC acknowledges that the activities of a "servicer" in the asset securitization process (Citibank, here) include "customer service and payment processing for the borrowers in the securitized pool and collection actions in accordance with the pooling and servicing agreement. Servicing can also include default management and collateral liquidation." Appendix, Exh. A (Asset Securitization) at 10. Not only do these materials demonstrate that the OCC has a system in place by which it regularly reviews and examines the asset securitization activities of national banks, but the original issuer of the credit card receivable subject to securitization retains the power to collect the underlying debt as part of the "servicer" role.

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[3] Given their size, only copies of the relevant sections of the "Asset Securitization" and "Credit Card Lending" sections of the Comptroller's Handbook are marked as Exhibits A and B and included in the attached Appendix. Complete copies of the "Asset Securitization" and "Credit Card Lending" sections of the Comptroller's Handbook can be found at http://www.occ.treas.gov/handbook/SS.HTM.

2. Citibank's Securitization And Servicing Of The Accounts Is Authorized And Regulated By The OCC.

As noted above, Defendant contends -- without citing any supporting authority -- that Citibank is not a "regulated lender" exempt under the ICAA because Citibank's collection of the receivables in the Master Trust "are not allowed by the OCC for a national bank and are *ultra vires* activities." (Opp. at 15-16.) According to Defendant, "Citibank terminated its role and capacity as a national bank or regulated lender when it sold the Receivables to the Master Trust." (Id. at 16.) Moreover, Defendant contends that, by selling its credit card receivables to the Master Trust, Citibank ceases to be a national bank and, instead, "adopts a new role, acting in the capacity of Servicer" and "[a]cting in the capacity of Servicer for the Master Trust is not a banking activity and is not authorized by the OCC." (Id. at 8.) As the authorities cited above confirm, Defendant's analysis is completely incorrect.

The OCC has expressly approved of the securitization of credit card receivables as "part of the business of banking" and a "permissible activity for a national bank." OCC Interpretive Letter No. 585, 1992 WL 598402 at * 2 (Jun. 8, 1992) (recognizing OCC's approval of asset securitization by national banks as a means of selling or borrowing against credit card receivables). In fact, the OCC specifically has approved the securitization of credit card receivables by Citibank, N.A. See OCC Corporate Decision No. 98-39, 1998 WL 667884, at *4 (Mar. 27, 1998). Moreover, the Comptroller's Handbook confirms that the powers of a "servicer" include the ability to collect the securitized receivables. Thus, Defendant cannot credibly argue that Citibank is not authorized by the OCC to act as a "servicer" or that Citibank ceases to be a national bank by transferring its credit card receivables to the Master Trust.

Nor can Defendant rely upon state law and this Court to seek a ruling preventing Citibank from exercising its powers as a national bank. Again, the OCC, the agency charged by Congress with overseeing federally-chartered national banks, has exclusive enforcement power against national banks, including with respect to alleged violations of state law. Here, the OCC has

specifically addressed, and issued rulings regarding, the conduct at issue. Accordingly, this Court must defer to the OCC in this regard particularly because state court litigation is preempted to the extent that it is used to prevent or interfere with a national bank's exercise of its powers.[4] See Nelson, 517 U.S. at 33; Marquette Nat'l Bank, 439 U.S. at 314-15.

The OCC's preemption regulations bolster this conclusion: "Except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized [non-real estate lending or deposit-taking] powers are not applicable to national banks." 12 C.F.R. §§ 7.4008(d)(1) & 7.4007(b)(1) (emphasis supplied). In other words, when a national bank is acting within its powers conferred under the National Bank Act, an express statement of federal law is required to permit state regulation. Similarly, with respect to the collection of debts, state laws relating to national banks' "rights to collect debts" survive preemption only if those laws fall outside the enumerated categories of express preemption set forth in Sections 7.4007(b)(2) and 7.4008(d)(2) and only if the laws "only incidentally affect" national banking operations. See 12 C.F.R. § 7.4007(c)(4), 7.4008(e)(4) & 7.4009(c)(2)(iv) (emphasis supplied). Again, as confirmed by the OCC, Citibank is acting

[4] Defendant cites Dun & Bradstreet, Inc. v. McEldowney, 564 F. Supp. 257 (D.C. Idaho 1983), apparently for the proposition that Citibank is not entitled to "federal protection or preemption" for its activities as "Servicer" of the Master Trust. See Opp. at 13. Dun & Bradstreet is easily distinguishable for a number of factual reasons, but, more importantly, it plainly is not applicable as a matter of law. Dun & Bradstreet, unlike Citibank, was a collection agency, admittedly engaged in collection activities as defined in the ICAA and was a permittee under the ICAA. 564 F. Supp. at 259. Thus, unlike Citibank, which as a national bank is a "regulated lender" and specifically exempt under the ICAA, Dun & Bradstreet was subject to the requirements of the ICAA. Furthermore, Dun & Bradstreet challenged whether the provisions of the ICAA's requiring collection agencies to maintain an in-state office and representative imposed an unreasonable restriction on interstate commerce in violation of the commerce clause. The decision has nothing whatsoever to do with the asset securitization practices of national banks and, specifically, whether national banks are authorized by the OCC to engage in "servicing" activities as part of that process (which they are as the OCC specifically has ruled). Finally, Idaho specifically exempts national banks from the ICAA. See I.C. § 26-2239(2); Larsen Aff., ¶ 4. Thus, Defendant's contention that state collection laws are not preempted by federal law is moot. Moreover, as discussed above, the OCC, as the appropriate regulator with respect to the debt collection activities of national banks, has preemption regulations, which apply here.

within its powers conferred under the National Bank Act when it transfers its credit card receivables to the Master Trust and, at the same time, seeks to collect the debt owed on the accounts.

In summary, based on the foregoing authority, there can be no dispute that the OCC is charged with overseeing the activities of a national bank and specifically authorizes the securitization and servicing activities at issue. Defendant cannot displace that authority by seeking an order from this Court preventing or interfering with Citibank's exercise of its powers under the National Bank Act. This is particularly true here, where the Idaho Legislature clearly has enacted legislation that, as confirmed by the Idaho Department of Finance, exempts "regulated lenders," including national banks, from any requirements, licensing or otherwise, under the ICAA. Accordingly, the ICAA does not apply here, and summary judgment should be entered in Citibank's favor on the amount due and owing on the Account.

B. Citibank Owns All The Credit Card Accounts Designated In The Master Trust And Controls, And Is The Primary Beneficiary Of, The Trusts Involved In the Securitization Process.

In opposing Citibank's Motion for Summary Judgment, Defendant fails to grasp the critical fact that the asset securitization process both starts and ends with Citibank maintaining ultimate control of the credit card accounts, the Issuance Trust and Master Trust. As a result, not only is Citibank exempt from the ICAA because it is a regulated lender, Citibank is also not subject to the ICAA because: (i) Citibank is collecting a debt that it owns on its own behalf; and (ii) the Issuance Trust and Master Trust are under common ownership and control with Citibank, which triggers the ICAA's related entity exemption under I.C. § 26-2239(10). In this regard, Defendant's Opposition is long on words, but short on substance. Despite her erroneous characterization of the asset securitization process, Citibank's documents speak for themselves and establish that neither Citibank nor its affiliated Trusts are subject to the ICAA for the reasons set forth in the Supplemental Brief and below.

1. Citibank Owns Defendant's Account.

The documents submitted by Citibank in connection with the Supplemental Brief indisputably confirm that Citibank owns all the credit card accounts involved in the asset securitization process and that Citibank is seeking to collect a debt which it owns, thus precluding the ICAA's application. See I.C. §§ 26-2222, 26-2223; Purco Fleet Servs., Inc. v. Idaho State Dept. of Fin., 140 Idaho 121, 90 P.3d 346, 350 (2004); February 5, 2007 Prospectus (Exh. A to the Supplemental Brief) at 101 ("Citibank (South Dakota) is the owner of all of the credit card accounts designated to the master trust."). Specifically, although the credit card receivables are transferred to the Master Trust, Citibank continues to "own the accounts themselves." Exh. A to the Supplemental Brief at 20, 100 ("Citibank (South Dakota) establishes the credit and risk criteria for the origination and acquisition of credit card accounts owned by it, including the accounts in the master trust."). Importantly, Citibank retains the right to change the terms of the accounts, including, without limitation, the fees, finance charges, interest rates or minimum monthly payments. Id. at 20. There are "no restrictions on Citibank (South Dakota)'s or its affiliates' ability to change the terms of the credit card accounts designated to the master trust," regardless of how such changes may effect the payment patterns on the credit card receivables in the Master Trust. Id. at 20-21.

Thus, in addition to the fact that that Citibank is a regulated lender exempt from the ICAA, the ICAA also does not apply to Citibank because Citibank is seeking to collect debts on accounts that it owns and for its own benefit, and not on another's behalf. Defendant's contention that Citibank is subject to I.C. § 26-2223(9) because Citibank acquired her Account (and the underlying debt) from the Master Trust after the Account was in default is false. Citibank has always owned the Account, including prior to the Account being charged-off and prior to filing the instant collection case. The fact that the receivables relating to the Account

may have been removed from the Master Trust when the Account was charged-off does not change the fact that Defendant's debt, and the corresponding obligation to repay such debt, is owed to Citibank, and not to the Master Trust. Nor does it alter Citibank's ownership of the Account, including Citibank's right to change the terms of the Account.

Put differently, the transfer of credit card receivables to the Master Trust is an unrelated transaction, separate and apart from Citibank's credit relationship with Defendant. On this point, the OCC instructs that the credit relationship between Defendant and Citibank continues to exist unchanged after transfer of the receivables to the Master Trust. See Exh. A (Asset Securitization) at 8 (recognizing that benefit of asset securitization process is that "originating bank is often able to maintain the customer relationship.") & 10 (stating that duties of original lender as "servicer" include customer service, payment processing, collection actions and default management).

Citibank remains obligated to perform under the card agreement governing the Account, and Defendant remains obligated to, among other things, repay the debt incurred on the Account. This is different than the situation in which ownership of an account is assigned to a different, unrelated financial institution and such institution then assumes Citibank's rights and obligations under the governing card agreement. In that case, the credit relationship is altered and the new institution attains, among other things, the right to collect any debt owed. Here, there is nothing to suggest that Citibank is doing anything but collecting a debt on its own behalf that Defendant owes to Citibank.[5] The securitization of Citibank's credit card receivables is not related in any way to Defendant's credit relationship with Citibank.

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[5] In this regard, the instant case is completely different from the circumstances at issue in Mountain Peaks Financial v. Edmondson, a decision issued by this Court. There, the facts demonstrated that Mountain Peaks Financial either acquired the student loan accounts at issue, or was collecting on such accounts solely for another unrelated entity, which brought it within the scope of the ICAA. Here, Citibank seeks to collect on an Account that only Citibank owns. Moreover, unlike Citibank, Mountain Peaks was not a national bank and "regulated lender" exempt from the ICAA.

In Davis v. Professional Bus. Servs, Inc., 109 Idaho 810, 712 P.2d 511, 517 (1985), the Idaho Supreme Court looked to the purpose of the ICAA, as interpreted by the Idaho Department of Finance, in order to determine its scope as whether a party was acting as a collection agency under the ICAA. The Court stated:

> The language of I.C. § 26-2223 is extremely broad. Conceivably, it could be said to cover any person who receives payment, even in the name of the creditor, for another. This could potentially include a billing clerk, receptionist, secretary, or anyone else who participates in an accounts receivable processing activity, other than the creditor itself. We are unable to perceive that the legislature so intended.
>
> The Idaho Department of Finance filed an amicus brief. Therein it explains its view that the Act in question was designed to (1) protect the creditor whose money is collected by an assignee-collector who, absent the Act's protection, might not deliver the collected proceeds to the creditor; and (2) protect the public from unscrupulous collectors. Neither of these two purposes were here served by the district court's conclusion that defendant operated without the law.

Id. Similarly here, applying the ICAA to Citibank would not further the purposes of the ICAA. Citibank is merely seeking to collect on an Account that it owns, and the securitization process has no bearing on Citibank's ability to obtain the proceeds of the debt. Moreover, Defendant fails to establish that the securitization process has resulted in any unscrupulous collection conduct. Indeed, Defendant is not a party to, and has no relationship with, the securitization process and the servicing of the Trusts. Accordingly, because Citibank seeks to collect on the Account for its own benefit, it is not subject to the ICAA.

2. Citibank Controls, And Is The Primary Beneficiary Of, The Trusts Involved In the Securitization Process.

Even assuming that Citibank is not a "regulated lender" exempt from the ICAA (which it is) and that Citibank is somehow collecting the Account on behalf of another (which it is not), Citibank, as well as the Master and Issuance Trusts, are exempt from the ICAA because the Trusts are under common ownership and control with Citibank. See I.C. § 26-2239(10). Here, the documents demonstrate Citibank is the primary beneficiary of, and exerts direct control over, the Issuance and Master Trusts. See Exh. A to the Supplemental Brief at 1-2 (Citibank "is the

manager of the issuance trust, and is responsible for making determinations with respect to the issuance trust and allocating funds received by the issuance trust.") & 34 (Citibank "is the sole owner of the beneficial interests in the issuance trust."). Defendant makes much of the fact that, under the Pooling & Service Agreement, Citibank sells the receivables to the Master Trust and purportedly relinquishes control over the receivables to the trustee of the Issuance Trust. (Opp. at 7-13.) Defendant overlooks, however, that Citibank -- not the trustee -- will "direct the actions to be taken by the issuance trust" and, under the trust agreement, the role of the trustee is "limited to ministerial actions," while "[a]ll material actions concerning the issuance trust are taken by [Citibank] as managing beneficiary of the issuance trust." Exh. A to the Supplemental Brief at 33, 34. Similarly, Citibank -- not the trustee -- possesses the right to add and remove receivables from the Master Trust. Id. at 103. Likewise, the Master Trust does not have any employees and "does not engage in any activity other than acquiring and holding trust assets and the proceeds of those assets, issuing series of investor certificates, making distributions and related activities." Id. at 101.

Simply put, neither the trustee nor the Master Trust obtain any indicia of ownership as part of the asset securitization process. As recognized by the OCC, asset securitization is the "structured process whereby interests in loans, and other receivables are packaged, underwritten, and sold in the form of 'asset-backed' securities." Exh. A ("Asset Securitization") at 2; Exh. B ("Credit Card Lending") at 52 ("Securitization is the pooling of assets with similar characteristics into a standard format for sale to investors."). Defendant does not refute the structure of the asset securitization process set forth in the Supplemental Brief. See Supplemental Brief at 4-6. As that process makes clear, Citibank does not transfer ownership of the accounts, and Defendant does not cite any authority to the contrary. Rather, Citibank simply is pledging its assets as part of an investment vehicle (in an OCC-approved transaction) that has

nothing whatsoever to do with Defendant. Most importantly, Citibank owns and controls that investment vehicle.

In the end, Citibank not only is the primary beneficiary of the Issuance Trust and Master Trust, but Citibank has direct control over such Trusts. See Supplemental Brief at 4-6. Citibank is responsible for servicing, managing, determining which receivables are included or removed from the Master Trust and allocating funds received by the Master Trust. Id. Accordingly, both trust entities and Citibank are under common ownership and control, and thus exempt from the ICAA pursuant to I.C. § 26-2239(10).

III. CONCLUSION

Defendant's only proffered reason that she should not be required to repay her Citibank credit card account is that Citibank is not licensed as a collection agency under the ICAA. Citibank, however, is not required to be licensed under the ICAA as a national bank and a "regulated lender." See Larsen Aff. The securitization process utilized by Citibank, and approved by the OCC, does not change this analysis. Nor does the securitization process remove Citibank as the owner of the Account at issue. Accordingly, based on the foregoing, and the reasons set forth in its Supplemental Brief, Citibank respectfully requests that the Court enter summary judgment in favor of Citibank and against Defendant.

DATED THIS 16th day of July 2007.

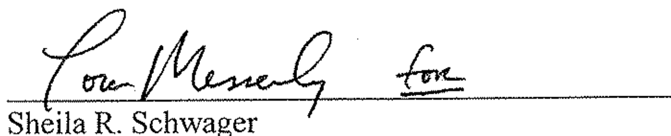
HAWLEY TROXELL ENNIS & HAWLEY LLP

By [signature] for
Sheila R. Schwager, ISB No. 5059
Attorneys for Plaintiff/Counterdefendant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 16th day of July, 2007, I caused to be served a true copy of the foregoing CITIBANK'S SUPPLEMENTAL REPLY BRIEF IN SUPPORT OF SUMMARY JUDGMENT by the method indicated below, and addressed to each of the following:

Ms. Miriam G. Carroll HC-11 Box 366 Kamiah, Idaho 83536 [*pro se*]	_X_ U.S. Mail, Postage Prepaid ____ Hand Delivered ____ Overnight Mail ____ Telecopy



Sheila R. Schwager

APPENDIX TO SUPPLEMENTAL REPLY BRIEF

INDEX TO APPENDIX

Exhibit A: Asset Securitization, Comptroller's Handbook, November 1997, 1-12 (Introduction & Securitization Process), 61-89 (Examination Objectives & Examination Procedures).

Exhibit B: Credit Card Lending, Comptroller's Handbook, October 1996, 1 (Introduction), 52-60 (Securitized Assets, Income Analysis for Securitized Assets, Purchased Credit Card Relationships & Glossary), 91-97 (Collections), 104-05 (Securitized Assets), 112-15 (Internal Control Questionnaire).

Collection Of Documents Authored By Office Of The Comptroller Of The Currency And Published On Westlaw:

1. OCC Corporate Decision No. 98-39, 1998 WL 667884 (Mar. 27, 1998);
2. OCC Interpretive Letter No. 585, 1992 WL 598402 (June 8, 1992);
3. OCC Interpretive Letter No. 540, 10 No. 2 OCC Q.J. 56, 1991 WL 570780 (June 1991);
4. OCC Interpretive Letter No. 452, 8 No. 1 OCC Q.J. 77, 1989 WL 451256 (Apr. 11, 1989);
5. OCC Interpretive Letter, 1985 WL 151323 (Aug. 27, 1985).

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Comptroller of the Currency
Administrator of National Banks

Asset Securitization

Comptroller's Handbook

November 1997

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Liquidity and Funds Management

EXHIBIT A

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Background

Asset securitization is helping to shape the future of traditional commercial banking. By using the securities markets to fund portions of the loan portfolio, banks can allocate capital more efficiently, access diverse and cost-effective funding sources, and better manage business risks

But securitization markets offer challenges as well as opportunity. Indeed, the successes of nonbank securitizers are forcing banks to adopt some of their practices. Competition from commercial paper underwriters and captive finance companies has taken a toll on banks' market share and profitability in the prime credit and consumer loan businesses. And the growing competition within the banking industry from specialized firms that rely on securitization puts pressure on more traditional banks to use securitization to streamline as much of their credit and originations business as possible. Because securitization may have such a fundamental impact on banks and the financial services industry, bankers and examiners should have a clear understanding of its benefits and inherent risks

This booklet begins with an overview of the securitization markets, followed by a discussion of the mechanics of securitization. The discussion evolves to the risks of securitization and how, at each stage of the process, banks are able to manage those risks.

A central theme of this booklet is the bank's use of asset securitization as a means of funding, managing the balance sheet, and generating fee income. The discussion of risk focuses on banks' roles as financial intermediaries, that is, as loan originators and servicers rather than as investors in asset-backed securities. Although purchasing asset-backed securities as investments clearly helps to diversify assets and manage credit quality, these benefits are discussed in other OCC publications, such as the "Investment Securities" section of the *Comptroller's Handbook*

Definition

Asset securitization is the structured process whereby interests in loans and other receivables are packaged, underwritten, and sold in the form of "asset-backed" securities. From the perspective of credit originators, this market enables them to transfer some of the risks of ownership to parties more willing or able to manage them By doing so, originators can access the funding markets at debt ratings higher than their overall corporate ratings, which generally gives them access to broader funding sources at more favorable rates. By removing the assets and supporting debt from their balance sheets, they are able to save some of the costs of on-balance-sheet financing and manage potential asset-liability mismatches and credit concentrations.

Brief History

Asset securitization began with the structured financing of mortgage pools in the 1970s For decades before that, banks were essentially portfolio lenders; they held loans until they matured or were paid off These loans were funded principally by deposits, and sometimes by debt, which was a direct obligation of the bank (rather than a claim on specific assets).

But after World War II, depository institutions simply could not keep pace with the rising demand for housing credit. Banks, as well as other financial intermediaries sensing a market opportunity, sought ways of increasing the sources of mortgage funding. To attract investors, investment bankers eventually developed an investment vehicle that isolated defined mortgage pools, segmented the credit risk, and structured the cash flows from the underlying loans. Although it took several years to develop efficient mortgage securitization structures, loan originators quickly realized the process was readily transferable to other types of loans as well

Since the mid 1980s, better technology and more sophisticated investors have combined to make asset securitization one of the fastest growing activities in the capital markets The growth rate of nearly every type of securitized asset has been remarkable, as have been the increase in the types of companies using securitization and the expansion of the investor base. The business of a credit intermediary has so changed that few banks, thrifts,

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or finance companies can afford to view themselves exclusively as portfolio lenders

Market Evolution

The market for mortgage-backed securities was boosted by the government agencies that stood behind these securities. To facilitate the securitization of nonmortgage assets, businesses substituted private credit enhancements. First, they overcollateralized pools of assets; shortly thereafter, they improved third-party and structural enhancements In 1985, securitization techniques that had been developed in the mortgage market were applied for the first time to a class of nonmortgage assets — automobile loans A pool of assets second only to mortgages, auto loans were a good match for structured finance; their maturities, considerably shorter than those of mortgages, made the timing of cash flows more predictable, and their long statistical histories of performance gave investors confidence

The first significant bank credit card sale came to market in 1986 with a private placement of $50 million of bank card outstandings. This transaction demonstrated to investors that, if the yields were high enough, loan pools could support asset sales with higher expected losses and administrative costs than was true within the mortgage market Sales of this type — with no contractual obligation by the seller to provide recourse — allowed banks to receive sales treatment for accounting and regulatory purposes (easing balance sheet and capital constraints), while at the same time allowing them to retain origination and servicing fees. After the success of this initial transaction, investors grew to accept credit card receivables as collateral, and banks developed structures to normalize the cash flows.

The next growth phase of securitization will likely involve nonconsumer assets. Most retail lending is readily "securitizable" because cash flows are predictable. Today, formula-driven credit scoring and credit monitoring techniques are widely used for such loans, and most retail programs produce fairly homogeneous loan portfolios Commercial financing presents a greater challenge. Because a portfolio of commercial loans is typically less homogeneous than a retail portfolio, someone seeking to invest in them must often know much more about each individual credit, and the simpler tools for

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measuring and managing portfolio risk are less effective. Nonetheless, investment bankers and asset originators have proven extremely innovative at structuring cash flows and credit enhancements Evidence of this can be seen in the market for securitized commercial real estate mortgages Commercial real estate is one of the fastest-growing types of nonconsumer assets in the securitization markets, which fund approximately 10 percent of commercial mortgage debt.

Benefits of Asset Securitization

The evolution of securitization is not surprising given the benefits that it offers to each of the major parties in the transaction

For Originators

Securitization improves returns on capital by converting an on-balance-sheet lending business into an off-balance-sheet fee income stream that is less capital intensive. Depending on the type of structure used, securitization may also lower borrowing costs, release additional capital for expansion or reinvestment purposes, and improve asset/liability and credit risk management

For Investors

Securitized assets offer a combination of attractive yields (compared with other instruments of similar quality), increasing secondary market liquidity, and generally more protection by way of collateral overages and/or guarantees by entities with high and stable credit ratings. They also offer a measure of flexibility because their payment streams can be structured to meet investors' particular requirements. Most important, structural credit enhancements and diversified asset pools free investors of the need to obtain a detailed understanding of the underlying loans This has been the single largest factor in the growth of the structured finance market.

For Borrowers

Borrowers benefit from the increasing availability of credit on terms that lenders may not have provided had they kept the loans on their balance

sheets For example, because a market exists for mortgage-backed securities, lenders can now extend fixed rate debt, which many consumers prefer over variable rate debt, without overexposing themselves to interest rate risk Credit card lenders can originate very large loan pools for a diverse customer base at lower rates than if they had to fund the loans on their balance sheet. Nationwide competition among credit originators, coupled with strong investor appetite for the securities, has significantly expanded both the availability of credit and the pool of cardholders over the past decade.

Before evaluating how a bank manages the risks of securitization, an examiner should have a fundamental understanding of asset-backed securities and how they are structured. This section characterizes asset-backed securities, briefly discusses the roles of the major parties, and describes the mechanics of their cash flow, or how funds are distributed.

Basic Structures of Asset-Backed Securities

A security's structure is often dictated by the kind of collateral supporting it. Installment loans dictate a quite different structure from revolving lines of credit Installment loans, such as those made for the purchase of automobiles, trucks, recreational vehicles, and boats, have defined amortization schedules and fixed final maturity dates Revolving loans, such as those extended to credit card holders and some home equity borrowers, have no specific amortization schedule or final maturity date. Revolving loans can be extended and repaid repeatedly over time, more or less at the discretion of the borrower.

Installment Contract Asset-Backed Securities

Typical installment contract asset-backed securities, which bear a close structural resemblance to mortgage pass-through securities, provide investors with an undivided interest in a specific pool of assets owned by a trust. The trust is established by pooling installment loan contracts on automobiles, boats, or other assets purchased from a loan originator, often a bank.

The repayment terms for most installment contract asset-backed securities call for investors to receive a pro rata portion of all of the interest and principal received by the trust each month. Investors receive monthly interest on the outstanding balance of their certificates, including a full month's interest on any prepayments The amount of principal included in each payment depends on the amortization and prepayment rate of the underlying collateral. Faster prepayments shorten the average life of the issue.

Revolving Asset Transactions

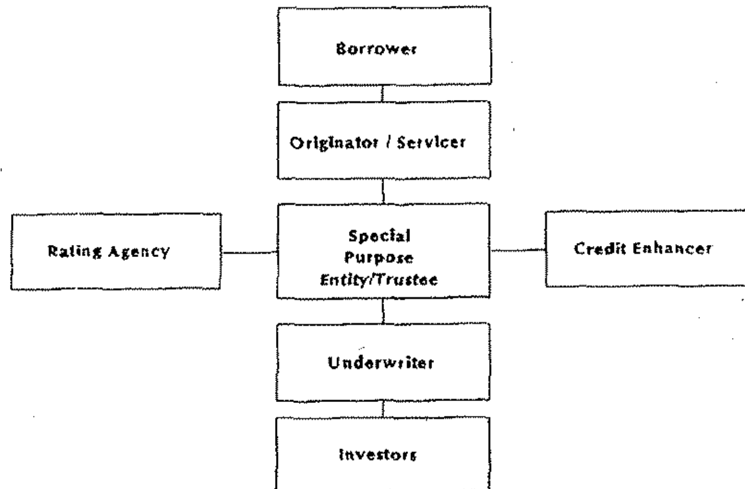
The typically short lives of receivables associated with revolving loan products (credit cards, home equity lines, etc) require issuers to modify the structures used to securitize the assets. For example, a static portfolio of credit card receivables typically has a life of between five months and ten months. Because such a life is far too short for efficient security issuance, securities backed by revolving loans are structured in a manner to facilitate management of the cash flows. Rather than distributing principal and interest to investors as received, the securities distribute cash flow in stages — a revolving phase followed by an amortization phase. During the revolving period, only interest is paid and principal payments are reinvested in additional receivables as, for example, customers use their credit cards or take additional draws on their home equity lines. At the end of the revolving period an amortization phase begins, and principal payments are made to investors along with interest payments Because the principal balances are repaid over a short time, the life of the security is largely determined by the length of the revolving period.

Parties to the Transaction

The securitization process redistributes risk by breaking up the traditional role of a bank into a number of specialized roles: originator, servicer, credit enhancer, underwriter, trustee, and investor Banks may be involved in several of the roles and often specialize in a particular role or roles to take advantage of expertise or economies of scale. The types and levels of risk to which a particular bank is exposed will depend on the organization's role in the securitization process.

With sufficient controls and the necessary infrastructure in place, securitization offers several advantages over the traditional bank lending model. These benefits, which may increase the soundness and efficiency of the credit extension process, can include a more efficient origination process, better risk diversification, and improved liquidity. A look at the roles played by the primary participants in the securitization process will help to illustrate the benefits.

Exhibit 1: Parties Involved in Structuring Asset-Backed Securities



Borrower. The borrower is responsible for payment on the underlying loans and therefore the ultimate performance of the asset-backed security. Because borrowers often do not realize that their loans have been sold, the originating bank is often able to maintain the customer relationship.

From a credit risk perspective, securitization has made popular the practice of grouping borrowers by letter or categories. At the top of the rating scale, 'A'-quality borrowers have relatively pristine credit histories. At the bottom, 'D'-quality borrowers usually have severely blemished credit histories. The categories are by no means rigid; in fact, credit evaluation problems exist because one originator's 'A' borrower may be another's 'A-' or 'B' borrower. Nevertheless, the terms 'A' paper and 'B/C' paper are becoming more and more popular.

Exhibit 2 is an example of generic borrower descriptions used by Duff and Phelps Credit Rating Corporation in rating mortgage borrowers. The borrowers' characteristics in the exhibit are generalizations of each category's standards and fluctuate over time; however, the table does provide an illustration of general standards in use today. For example, an 'A' quality

Exhibit 2: Borrower Credit Quality Categories

Generic Borrower Credit Quality Description	Mortgage Credit	Other Credit	Recency of Bankruptcy	Debt to Income Ratio	Loan-to-Value Guidelines
A: Standard agency quality	1 x 30 last 12 months	No derogatories	5 yrs	36%	97%
A-: Very minor credit problems	1 x 30 last 12 months 2 x 30 last 24 months	Minor derogatories explained	5 yrs	42%	90%
B: Minor to moderate credit problems	4 x 30 last 12 months 1 x 60 last 24 months	Some prior defaults	3 yrs	50%	75%
C: Moderate to serious credit problems	6 x 30 last 12 months 1 x 60 & 1 x 90 last 12 months	Significant credit problems	18 months	55%	70%
D: Demonstrated unwillingness or inability to pay	30-60 constant delinquent 2 x 90 last 12 months	Severe credit problems	12 months	60%	65%

(Source: Duff & Phelps)

borrower will typically have an extensive credit history with few if any delinquencies, and a fairly strong capacity to service debt. In contrast, a 'C' quality borrower has a poor or limited credit history, numerous instances of delinquency, and may even have had a fairly recent bankruptcy. Segmenting borrowers by grade allows outside parties such as rating agencies to compare performance of a specific company or underwriter more readily with that of its peer group.

Originator. Originators create and often service the assets that are sold or used as collateral for asset-backed securities. Originators include captive finance companies of the major auto makers, other finance companies, commercial banks, thrift institutions, computer companies, airlines, manufacturers, insurance companies, and securities firms. The auto finance companies dominate the securitization market for automobile loans Thrifts securitize primarily residential mortgages through pass-throughs, pay-throughs, or mortgage-backed bonds Commercial banks regularly originate and securitize auto loans, credit card receivables, trade receivables, mortgage loans, and more recently small business loans. Computer companies, airlines, and other commercial companies often use securitization to finance receivables generated from sales of their primary products in the normal course of business

Servicer. The originator/lender of a pool of securitized assets usually continues to service the securitized portfolio (The only assets with an active secondary market for servicing contracts are mortgages.) Servicing includes customer service and payment processing for the borrowers in the securitized pool and collection actions in accordance with the pooling and servicing agreement. Servicing can also include default management and collateral liquidation. The servicer is typically compensated with a fixed normal servicing fee

Servicing a securitized portfolio also includes providing administrative support for the benefit of the trustee (who is duty-bound to protect the interests of the investors). For example, a servicer prepares monthly informational reports, remits collections of payments to the trust, and provides the trustee with monthly instructions for the disposition of the trust's assets Servicing reports are usually prepared monthly, with specific format requirements for each performance and administrative report. Reports are distributed to the investors, the trustee, the rating agencies, and the credit enhancer.

Trustee. The trustee is a third party retained for a fee to administer the trust that holds the underlying assets supporting an asset-backed security. Acting in a fiduciary capacity, the trustee is primarily concerned with preserving the rights of the investor The responsibilities of the trustee will vary from issue to issue and are delineated in a separate trust agreement Generally, the trustee oversees the disbursement of cash flows as prescribed by the indenture or pooling and servicing agreement, and monitors compliance with appropriate covenants by other parties to the agreement

If problems develop in the transaction, the trustee focuses particular attention on the obligations and performance of all parties associated with the security, particularly the servicer and the credit enhancer Throughout the life of the transaction the trustee receives periodic financial information from the originator/servicer delineating amounts collected, amounts charged off, collateral values, etc. The trustee is responsible for reviewing this information to ensure that the underlying assets produce adequate cash flow to service the securities. The trustee also is responsible for declaring an event of default or an amortization event, as well as replacing the servicer if it fails to perform in accordance with the required terms.

Credit Enhancer Credit enhancement is a method of protecting investors in the event that cash flows from the underlying assets are insufficient to pay the interest and principal due for the security in a timely manner. Credit enhancement is used to improve the credit rating, and therefore the pricing and marketability of the security

As a general rule, third-party credit enhancers must have a credit rating at least as high as the rating sought for the security Third-party credit support is often provided through a letter of credit or surety bond from a highly rated bank or insurance company. Because there are currently few available highly rated third-party credit enhancers, internal enhancements such as the senior/subordinated structure have become popular for many asset-backed deals. In this latter structure, the assets themselves and cash collateral accounts provide the credit support These cash collateral accounts and separate, junior classes of securities protect the senior classes by absorbing defaults before the senior position's cash flows are interrupted

Rating Agencies. The rating agencies perform a critical role in structured finance — evaluating the credit quality of the transactions. Such agencies are considered credible because they possess the expertise to evaluate various underlying asset types, and because they do not have a financial interest in a security's cost or yield. Ratings are important because investors generally accept ratings by the major public rating agencies in lieu of conducting a due diligence investigation of the underlying assets and the servicer.

Most nonmortgage asset-backed securities are rated. The large public issues are rated because the investment policies of many corporate investors require ratings. Private placements are typically rated because insurance companies are a significant investor group, and they use ratings to assess capital reserves against their investments Many regulated investors, such as life insurance companies, pension funds, and to some extent commercial banks can purchase only limited amounts of securities rated below investment grade.

The rating agencies review four major areas:

- Quality of the assets being sold,
- Abilities and strength of the originator/servicer of the assets,

- *Soundness of the transaction's overall structure,* and
- Quality of the credit support.

From this review, the agencies assess the likelihood that the security will pay interest and principal according to the terms of the trust agreement The rating agencies focus solely on the credit risk of an asset-backed security. They do not express an opinion on market value risks arising from interest rate fluctuations or prepayments, or on the suitability of an investment for a particular investor.

Underwriter The asset-backed securities underwriter is responsible for advising the seller on how to structure the security, and for pricing and marketing it to investors Underwriters are often selected because of their relationships with institutional investors and for their advice on the terms and pricing required by the market They are also generally familiar with the legal and structural requirements of regulated institutional investors

Investors. The largest purchasers of securitized assets are typically pension funds, insurance companies, fund managers, and, to a lesser degree, commercial banks The most compelling reason for investing in asset-backed securities has been their high rate of return relative to other assets of comparable credit risk The OCC's investment securities regulations at 12 CFR 1 allow national banks to invest up to 25 percent of their capital in "*Type V*" *securities* By definition, a Type V security:

- Is marketable,
- Is rated investment grade,
- Is fully secured by interests in a pool of loans to numerous obligors and in which a national bank could invest directly, and
- Is not rated as a mortgage-related or Type IV security.

Structuring the Transaction

The primary difference between whole loan sales or participations and securitized credit pools is the structuring process. Before most loan pools can be converted into securities, they must be structured to modify the nature of the risks and returns to the final investors. Structuring includes the isolation

1. To determine the quantity of risk and the quality of risk management by assessing whether the bank is properly identifying, measuring, monitoring, and controlling the risks associated with its securitization activities.

2. To determine whether the bank's strategic or business plan for asset securitization adequately addresses resource needs, capital requirements, and profitability objectives.

3. To determine whether asset securitization policies, practices, procedures, objectives, internal controls, and audit functions are adequate.

4. To determine that securitization activities are properly managed within the context of the bank's overall risk management process.

5. To determine the quality of operations and the adequacy of MIS.

6. To determine compliance with applicable laws, rulings, regulations, and accounting practices.

7. To determine the level of risk exposure presented by asset securitization activities and evaluate that exposure's impact on the overall financial condition of the bank, including the impact on capital requirements and financial performance.

8. To initiate corrective action when policies, practices, procedures, objectives, or internal controls are deficient, or when violations of law, rulings, or regulations have been noted.

Many of the steps in these procedures require examiners to gather information from or review information with examiners in other areas, particularly those responsible for originating assets used in securitized pools (e.g., retail lending, mortgage banking, credit card lending) To avoid duplicating examination procedures already being performed in these areas, examiners should discuss and share examination data related to asset securitization with examiners from these other areas before beginning these procedures

Examiners should cross-reference information obtained from other areas in their examination work papers. When information is not available from other examiners, it should be requested directly from the bank. The final decision on the scope of the examination and the most appropriate way to obtain information rests with the examiner-in-charge (EIC).

The examination procedures in the first section ("Overview") will help the examiner determine how the bank securitizes and the general level of management and board oversight. The procedures in the second section ("Functions") supplement the "Overview" section and will typically be used for more in-depth reviews of operational areas. The procedures in "Overall Conclusions" (#s 67-71) should be completed for each examination.

Overview

1. Obtain and review the following documents:

   - ☐ Previous examination findings related to asset securitization and management's response to those findings.
   - ☐ Most recent risk assessment profile of the bank.
   - ☐ Most recent internal/external audits addressing asset securitization and management's response to significant deficiencies.
   - ☐ Supervisory Monitoring System (SMS) reports.
   - ☐ Scope memorandum issued by the bank EIC

- ☐ Strategic or business plan for asset securitization.
- ☐ All written policies or procedures related to asset securitization.
- ☐ A description of the risk measurement and monitoring system for securitization activities and a copy of all related MIS reports. (Measurement systems may include tracking reports, exposure reports, valuation reports, and profitability analyses. See the examination procedures under "Management Information Systems" for additional details.)
- ☐ A summary or outline of all outstanding asset-backed issuances. Document for the permanent work paper file information for each outstanding security including:
  - The origination date, original deal amount, current outstanding balance, legal maturity, expected maturity, maturity type (hard bullet, soft bullet, controlled amortization, etc.), revolving period dates, current coupon rates, gross yield, loss rate, base rate, excess spread amounts (one month and three month), monthly payment rates, and the existence of any interest rate caps.
  - The amount and form of credit enhancements (over-collateralization, cash collateral accounts, spread accounts, etc.).
  - Performance triggers relating to early amortization events or credit enhancement levels
- ☐ Copies of pooling and servicing agreements and/or series supplements for major asset types securitized or those targeted at this exam.
- ☐ Information detailing the potential contractual or contingent liability from guarantees, underwriting, and servicing of securitized assets.
- ☐ Copies of compensation programs, including incentive plans, for personnel involved in securitization activities
- ☐ Current organizational chart for the asset securitization unit of the bank.
- ☐ A list of board and executive or senior management committees that supervise the asset securitization function, including a list of members and meeting schedules. Also, minutes documenting meetings held since the last examination should be available for review.

2. Determine whether any material changes have occurred since the last review regarding originations and purchases, servicing, or managing securitized portfolios.

3. Based on results from the previous steps and discussions with the bank EIC and other appropriate supervisors, determine the scope and objectives of the examination.

Select from among the following examination procedures the steps necessary to meet examination objectives. Examiners should tailor the procedures to the specific activities and risks faced by the bank. Note: Examinations will seldom require completion of all steps.

4. As examination procedures are performed, test for compliance with established policies and confirm the existence of appropriate internal controls. Identify any area that has inadequate supervision or poses undue risk, and discuss the need to perform additional or expanded procedures with the EIC.

Management Oversight

5. Review the bank's securitization business plan. Determine that it has been reviewed by all significant affected parties and approved by the bank's board of directors. At a minimum, the plan should address the following:

   a. The integration of the securitization program into the bank's corporate strategic plan

   b. The integration of the securitization program into the bank's asset/liability, contingency funding, and capital plans.

   c. The integration of the securitization program into the bank's compliance review, loan review, and audit program.

   d. The specific capacities in which the bank will engage (servicer, trustee, credit enhancer, etc.)

e. The establishment of a risk identification process.

f The type(s) and volume of business to be done in total (aggregate of deals in process as well as completed deals that are still outstanding).

g. Profitability objectives.

6. Evaluate the quality of the business plan. Consider whether:

   a. The plan is reasonable and achievable in light of the bank's capital position, physical facilities, data processing systems capabilities, size and expertise of staff, market conditions, competition, and current economic forecasts

   b. The feasibility analysis considers tax, legal, and resource implications.

   c The goals and objectives of the securitization program are compatible with the overall business plan of the bank, the holding company, or both.

7. Determine whether the bank has and is following adequate policies and operating procedures for securitization activities. At a minimum, policies should address:

   a Permissible securitization activities including individual responsibilities, limits, and segregation of duties

   b. Authority levels and responsibility designations covering:

      - Transaction approvals and cancellations;
      - Counterparty approvals for all outside entities the bank is doing business with (originators, servicers, packagers, trustees, credit enhancers, underwriters, and investors);
      - Systemic and individual transaction monitoring;
      - Pricing approvals;
      - Hedging and other pre-sale decisions;

- Quality standard approvals; and
- Supervisory responsibilities over personnel.

c. Exposure limits by:

- Type of transaction;
- Individual transaction dollar size;
- Aggregate transactions outstanding (because of the moral recourse implicit in the bank's name on the securities);
- Geographic concentrations of transactions (individually and in aggregate);
- Maturities of transactions (particularly important in evergreen deals, i e., credit cards and home equity lines); and
- Originators (for purchased assets), credit enhancers, trustees, and servicers

d. Quality standards for all transactions in which the bank plans to participate. Standards should extend to all counterparties conducting business with the bank.

e. Minimum MIS reports to be presented to senior management and the board or appropriate committees (During reviews of applicable meeting minutes, ascertain which reports are presented and the depth of discussions held)

8. Review the organizational structure and determine who is responsible for coordinating securitization activities.

   a. Determine whether the board of directors or appropriate committee and management have a separate securitization steering committee. If so, review committee minutes for significant information.

   b. Determine whether decision making is centralized or delegated.

   c. Determine which individuals are responsible for major decisions and where final decisions are made.

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9. Determine whether, before approving a new securitization transaction, the bank requires sign-off from the following departments:

   - Appropriate credit division
   - Treasury or capital markets
   - Audit
   - Asset and liability management
   - Capital planning committee
   - Legal
   - Liquidity management
   - Operations

10. Assess the expertise and experience of management responsible for securitization activities.

    a. Conduct interviews and review personnel files and resumes to determine whether management and other key staff members possess appropriate experience or technical training to perform their assigned functions.

    b. Review management succession plans and determine whether designated successors have the necessary background and experience.

11. Review incentive plans covering personnel involved in the securitization process. Determine whether plans are oriented toward quality execution and long-run profitability rather than high-volume, short-term asset production and sales.

    a. Ensure that such plans have been approved by the board of directors or an appropriate committee.

    b. Determine that senior management and the board of directors are aware of any substantial payments or bonuses made under these plans.

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12. Evaluate the pricing system used in all aspects of securitization

   a. Determine that the bank has a system for quantifying costs and risks (liquidity, credit, transaction, etc.) and for making incremental adjustments to compensate for the less readily quantifiable costs and risks.

   b. Determine whether decision makers use an effective pricing system to determine whether prospective transactions will be profitable

Risk Management

13. Determine whether the risk management process is effective and based on timely and accurate information. Evaluate its adequacy in managing significant risks in each area of the securitization process.

   a. Ascertain whether management has identified all significant risks in each of the bank's planned roles.

   b. Determine how these risks are monitored and controlled.

   c. Evaluate how controls are integrated into overall bank systems.

   d. Evaluate management's method of allocating capital or reserves to various business units in recognition of securitization risks.

14. Determine that the bank's obligations from securitization activities have been reviewed by appropriate legal counsel

   a. Ensure that legal counsel has reviewed and approved any standardized documents used in the securitization process. Counsel should also review any transactions that deviate significantly from standardized documents.

   b. If the bank is involved in issuing prospectuses or private placement memoranda, ensure that legal counsel has reviewed them. Also,

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ensure that operating practices require a party independent of the securitization process to check the financial and statistical information in the prospectus for accuracy

15. Determine that the scope of credit and compliance reviews includes loans originated for securitization or purchased for that purpose.

    a. Ascertain appropriateness of scope, frequency, independence, and competency of reviews in view of the bank's activity volume and risk exposure

    b. Credit and compliance reviews should include:

        - Loans on the bank's books and not yet securitized;
        - Loans in process of being securitized; and
        - Completed deals that bear the bank's name or in which the bank has ongoing responsibilities (servicer, trustee, etc.).

Portfolio Management

16. Determine whether management's assessment of the quality of loan origination and credit risk management includes *all* managed assets (receivables in securitization programs and on-balance-sheet assets). At a minimum, the assessment should include:

    a. A review of the number and dollar volume of existing past-due loans, early payment defaults, and repurchased loans from securitized asset pools. The review should also compare the bank's performance to industry, peer group averages, or both.

    b. An analysis of the cause of delinquencies and repurchases

    c. The impact on delinquencies and losses of altered underwriting practices, new origination sources, and new products.

    d. Determination of whether repurchases or other workout actions compromised the sales status of problem credits or related assets.

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17 Determine whether the bank performs periodic stress tests of securitized asset pools. Determine whether these tests:

a Consider the appropriate variables affecting performance according to asset or pool type

b. Are conducted well in advance of approaching designated early amortization triggers.

c. Are adequately documented

18 If third parties provide credit or liquidity enhancements for bank-sponsored asset-backed securities, determine whether their credit rating has been downgraded recently or whether their credit quality has deteriorated If so, determine what actions the bank has taken to mitigate the impact of these events

19. Assess whether securitization activities have been adequately integrated into liquidity planning. Consider whether:

a. The cash flows from scheduled maturities of revolving asset-backed securities are coordinated to minimize potential liquidity concerns.

b The impact of unexpected funding requirements due to early amortization events are factored into contingency funding plans for liquidity.

Internal and External Audit

20. Review the bank's internal audit program for securitization activities. Determine whether it includes objectives, written procedures, an audit schedule, and reporting systems that are appropriate in view of the bank's volume of activity and risk exposure

a Review the education, experience, and ongoing training of the internal audit staff and evaluate its expertise in auditing securitization activities.

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b. Determine whether comprehensive audits of all securitization areas are conducted in a timely manner Ensure that the scope of internal audit includes:

- An evaluation of compliance with pooling and servicing agreement requirements; and
- Periodic verification of the accuracy of both internal and external portfolio performance reports

c Review management's responses to audit reports for timeliness and implementation of corrective action when appropriate.

21. If the external auditors review the major operational areas involved in securitization activities, review the most recent engagement letter, external audit report, and management letter. Determine:

a. To what extent the external auditors rely on the internal audit staff and the internal audit report

b. Whether the external auditors rendered an opinion on the effectiveness of internal controls for the major products or services related to securitization.

c Whether management promptly and effectively responds to the external auditor's concerns and recommendations. Assess whether management makes changes to operating and administrative procedures that are appropriate responses to report findings.

Management Information Systems

22 Review management information systems to determine whether they provide appropriate information for monitoring securitization activities.

a. Evaluate reports produced for each capacity in which the bank is involved. At a minimum, the following should be produced:

- Tracking reports to monitor overall securitization activity. Reports should include:

- Completed transactions, transactions in process, *and prospective transactions;*
- Exposure reports detailing exposures by specific function (credit enhancer, servicer, trustee, etc.) and by counterparties; and
- Profitability analysis by product and functional department (originations, servicing, trustees, etc) Profitability reports should include cost-center balance sheet and earnings statements The balance sheets should reflect the amount of capital and reserves set aside for risks within the various functions.

• Inventory reports to monitor available transaction collateral Reports should include summaries by:

  - Product type, including outstanding and committed receivable amounts;
  - Geographic or other types of concentrations; and
  - Sale status (for transactions in process).

• Performance reports by portfolio and specific product type Reports should reflect performance of both assets in securitized pools and total managed assets Reports should include:

  - Credit quality (delinquencies, losses, portfolio aging, etc.);
  - Profitability *(by individual transaction and product* type); and
  - Performance compared with expected performance (portfolio yields, monthly principal payment rates, purchase rates, charge-offs, etc.).

b. Determine whether MIS provides sufficient detail to permit reviews for compliance with policy limits and to make appropriate disclosures on regulatory reports and other required financial statements. Evaluate whether:

- The frequency of report generation is commensurate with volume and risk exposure; and
- Reports are distributed to, and reviewed by, appropriate management, board committees, or both.

23. Determine whether investor reporting is accurate and timely. Choose a sample of outstanding transactions and compare internal performance reports with those provided to investors. Note: Examiners can supplement this procedure by comparing internal reports with information reported by external sources (such as Bloomberg, Fitch, and Moody's) Discrepancies should be brought to management's attention immediately.

Accounting and Risk-Based Capital

24. Determine whether the bank is classifying securitization transactions appropriately as "sales" or "financings "

    a. Determine that the bank has a system to ensure that independent personnel review transactions and concur with accounting treatment.

    b. Ensure that audit has tested for proper accounting treatment as part of its normal reviews

25. For transactions that qualify for sales treatment under FAS 125, review the written policies and procedures to determine whether they:

    a. Allocate the previous book carrying amount between the assets sold and the retained interests based on their fair market values on the date of transfer.

    b. Adjust the net proceeds received in the exchange by recording, on the balance sheet, the fair market value of any guarantees, recourse obligations, or derivatives such as put options, forward commitments, interest rate swaps, or currency swaps

    c. Recognize gain or loss only on assets sold

d. Continue to carry on the balance sheet any retained interest in the transferred assets. Such balance sheet items should include servicing assets, beneficial debt or equity interests in the special-purpose entity, or retained undivided interests.

26. Determine whether the asset values and periodic impairment analyses for servicing assets and rights to future excess interest (IO strips) are consistent with FAS 125 and regulatory accounting requirements.

   a. Determine whether the bank has a reasonable method for determining fair market value of the assets

   b. Determine whether recorded servicing and IO strip asset values are reviewed in a timely manner and adjusted for changes in market conditions.

   For servicing assets, verify that:

   - Servicing assets are appropriately stratified by predominant risk characteristics (e.g., asset type, interest rate, date of origination, or geographic location);
   - Impairment is recognized by stratum;
   - Impairment is assessed frequently (e.g., at least quarterly);
   - Assumptions and calculations are documented; and
   - Servicing assets are not recorded at a value greater than their original allocated cost.

   For IO strip assets, verify that:

   - Valuation considers changes in expected cash flows due to current and projected volatility of interest rates, default rates, and prepayment rates; and
   - IO strips are recorded at fair market value consistent with available-for-sale or trading securities

   c. Determine that servicing assets and IO strips are accorded appropriate risk-based capital treatment. Ensure that:

- Nonmortgage servicing assets are fully deducted from Tier 1 capital and risk-weighted assets. (Mortgage-related servicing assets and purchased credit card relationships may be included in Tier 1 capital; however, the total of all mortgage related servicing assets and purchased credit card relationships is limited. See 12 CFR 3 and related interpretations.)
- Risk-based capital is allocated for the lower of the full amount of the assets transferred or the amount of the IO strip, consistent with low-level recourse rules.

27 For revolving trusts, review procedures for accounting for new sales of receivables to the trust.

   a. Verify that accrued interest on receivables sold is accounted for properly

   b. Determine whether gain or loss is properly booked

28. Determine whether the bank maintains capital reserves for securitized assets. Determine whether the method for calculating the reserves is reasonable. Consider:

   a. The volume and nature of servicing obligations

   b The potential impact on liquidity of revolving-asset pools.

   c. Other potential exposures

Recourse Transactions

29. Determine whether the bank transfers loans with recourse. If so, determine whether:

   a. Written policies guide management with respect to the type and amount of recourse it can offer Such policies should address:

      - Full or partial recourse specified in the servicing contract;

- Warranties and representations in the sale of loans, including warranties against noncompliance with consumer laws and regulations;
- Repurchase agreements in case of early default or early prepayment of securitized loans;
- Spread accounts or cash reserves;
- Vested business relationships with purchasers of whole loans or investors in asset-backed securities; and
- Environmental hazards

b. Adequate management information systems exist to track all recourse obligations

c. Asset sales with recourse, including low-level transactions, are reported appropriately in schedule RC-R of the report of condition and income (call report).

d. If recourse is limited, determine whether the bank's systems prevent it from making payments greater than its contractual obligation to purchasers.

30. Determine whether the bank has developed written standards for refinancing, renewing, or restructuring loans previously sold in asset-backed securities transactions. Determine whether:

a. The standards distinguish a borrower's valid desire to reduce an interest rate through renewal, refinancing, or restructuring designed to salvage weak credits.

b. The standards prevent the bank from repurchasing distressed loans from the securitized credit pool and disguising their delinquency in the bank's loan portfolio.

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Functions

The following guidelines supplement the procedures in the "Overview" section. These procedures will often be performed by product (loan) type and should be coordinated with other examination areas to avoid duplication of effort.

Originations

31 Determine whether senior management or the board is directly involved in decisions concerning the quality and types of assets that are to be securitized as well as those to be retained on the balance sheet. Ensure that written policies:

a Outline objectives relating to securitization activities.

b. Establish limits or guidelines for:

- Quality of loans originated
- Maturity of loans originated
- Geographic dispersion of loans
- Acceptable range of loan yields
- Credit quality
- Acceptable types of collateral
- Types of loans

32 Determine whether the credit standards for loans to be securitized are the same as the ones for loans to be retained.

a. If not, ascertain whether management consciously made this decision and that it is clearly stated in the securitization business plan

b. If higher quality loans are to be securitized in order to gain initial market acceptance, determine whether the bank limits the amount of lower quality assets it originates or retains. Also, determine whether the allowance for loan and lease losses and capital are adjusted for the higher proportion of risk in total assets.

c. Determine whether there are sufficient administrative and collection personnel on hand to properly administer and collect lower quality credits.

33. Ensure that there is a complete separation of duties between the credit approval process and loan sales/securitization effort. Determine whether lending personnel are solely responsible for:

    a. The granting or denial of credit to customers.

    b. Credit approvals of resale counterparties

34. Ensure that loans to be sold or securitized are segregated or otherwise identified on the books of the originating bank Also, determine that the bank is following appropriate accounting standards regarding market valuation procedures on assets held for sale.

35. If loans are granted or denied based on a credit scoring system, ascertain whether the system was developed based on empirically derived data Ensure that it is periodically revalidated.

36. Determine whether the bank is making efforts to ensure that the customer base is not suffering from economic redlining. If economic redlining is occurring, determine what actions the bank is taking to counteract these effects. (Evidence of redlining should be immediately discussed with the EIC and/or appropriate compliance examiner.)

37 Determine whether written policies address borrower's expectations of confidentiality and rights to financial privacy by requiring:

    a. The opinion of counsel on what matters may be disclosed.

    b. Written notice (when counsel deems it necessary) that loans may be sold in whole or pledged as collateral for asset-backed securities and that certain confidential credit information may be disclosed to other parties

    c. When necessary, the borrower's written waiver of confidentiality.

Purchased Loans

38. Determine whether the bank has written procedures on acquiring portfolios for possible securitization. If so, determine whether the procedures are adequate given the volume and complexity of the potential purchases.

39. Evaluate management's method of determining whether prospective asset purchases meet the quality standards represented by the seller Ensure that the process considers whether purchased assets are compatible with the bank's data systems, administration and collection systems, credit review talent, and compliance standards, particularly consumer protection laws.

40 If the bank has recently purchased a portfolio for use in a securitization transaction, review the due diligence work papers to assess their adequacy and compliance with policy

41. Determine whether the bank conducts postmortem reviews on acquired portfolios, and, if so, what procedures are used. Identify who receives the results and whether appropriate follow-up action is taken (changes in quality standards, due diligence procedures, etc)

42 Ensure that operating systems segregate or otherwise identify loans being held for resale. Review accounting practices to ensure appropriate treatment of assets held for resale.

43. Evaluate the measures taken to control pipeline exposure.

    a. If pre-sales are routine, determine whether credit approval and diversification standards for purchasers are administered by people who are independent of the asset purchasing and packaging processes.

    b. Evaluate the reasonableness of limits on inventory positions that are not pre-sold or hedged.

c. If assets held for resale are required to be hedged, ensure that controls over hedging include:

- An approved list of hedging instruments;
- Minimum acceptable correlation between the assets held for sale and the hedging vehicle;
- Maximum exposure limits to unhedged loan commitments under various interest rate simulations;
- Credit limits on forward sale exposure to a single counterparty;
- A prohibition against speculation; and
- Acceptable reporting systems for hedging transactions.

Servicing

44. Determine whether written policies are in place for servicing activities that:

    a. Outline objectives for the servicing department

    b List the types of loans that the bank is permitted to service

    c. Specify procedures for valuing retained and purchased servicing rights

    d. Require legal counsel to review each transaction for conflicts of interest when the bank serves in multiple capacities such as:

    - Originator
    - Servicer
    - Trustee
    - Credit enhancer
    - Market maker
    - Lender in other relationships to borrowers, investors, originators
    - Investor

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45. Determine whether MIS reports for the servicing operation provide adequate information to monitor servicing activities. Reports by asset pool or transaction should include:

   a. Activity data, including:

      - Aggregate data such as number of loans, dollar amount of loans, yield on loans.
      - Delinquency information for at least the loans that are more than 15/30/60/90 days past due;
      - Number and dollar amount of early payment default (within first three months of closing);
      - Charge-off data; and
      - Repossession costs (if applicable)

   b. Profitability information, including all costs associated with direct and indirect overhead, capital, and collections.

   c. Comparisons of the servicer's costs and revenues with industry averages.

46. Evaluate management's planning process for future servicing activities. Determine whether:

   a. Current systems are capable of handling the requirements for the current and anticipated securitization volume.

   b The planning process for the development of operating systems has been coordinated with plans for anticipated future growth in servicing obligations

   c Provisions exist for complete testing and personnel training before adding systems or changing existing ones significantly

   d A sufficient number of experienced credit administration and workout personnel are available to meet the added demands associated with increased transaction and account volumes.

47 Determine whether the bank has contracted for an appropriate amount of errors and omissions insurance to cover the risks associated with the added transaction volumes from securitization activities.

48 Determine whether internal or external auditors review the servicing function. Determine whether they:

a Verify loan balances.

b Verify notes, mortgages, security interests, collateral, etc., with outside custodians.

c Review loan collection and repossession activities to determine that the servicer:

- Promptly identifies problem loans;
- Charges off loans in a timely manner;
- Follows written guidelines for extensions, renegotiations, and renewal of loans;
- Clears stale items from suspense accounts in a timely manner; and
- Accounts for servicing fees properly (by amortizing excess servicing fees, for example).

Collections

49. Review policies and procedures for collecting delinquent loans.

a Determine whether collection efforts are consistent with pooling and servicing agreement guidelines

b Determine whether the bank documents all attempts to collect past-due payments, including the date(s) of borrower contact, the nature of communication, and the borrower's response/comment.

c. Evaluate methods used by management to ensure that collection procedures comply with applicable state and federal laws and regulations

Other Roles

Credit Enhancement Provider

50 If the bank enhances the credit of securitized products it *originates*, ensure that:

a It appropriately classifies the transactions as "financings" or "sales."

b. Accounting for this obligation does not underestimate predictable losses or overestimate the adequacy of loan loss reserves.

c. Standards for enhancing the bank's own originations are not more liberal than standards applied to securitized products originated by others.

51. Ensure that the authority to enhance the credit of other banks' securitization programs is solely in the hands of credit personnel.

52 Determine that *all* credit enhancement exposures are analyzed during the bank's internal credit review process At a minimum, ensure that:

a. The accounting for this contingent obligation does not underestimate predictable loan losses or overestimate the adequacy of loan loss reserves.

b. The limits on securitized credits that the bank enhances reflect the bank's overall exposure to the originator and packager of the securitized credits.

c. The bank consolidates its exposure to securitized credits it enhances with exposure to the same credits held in its own loan portfolio.

53. Determine whether the bank has established exposure limits for pertinent credit criteria, such as the enhancer's exposure by customers, industry, and geography. Determine whether these exposures are incorporated into systemic exposure reports

54 Ascertain whether the bank has the capacity to fund the support they have provided Evaluate whether the bank considers this contingent obligation in its contingency funding plans

55. Determine that the bank's business plan for credit enhancement addresses capital allocation and ensure that the associated costs of capital usage are incorporated into pricing and transaction decisions

56 If credit enhancement facilities are provided for third parties, ensure that risk-based capital allocations are consistent with current guidelines set forth in 12 CFR 3 and the "Instructions for the Consolidated Reports of Condition and Income."

Trustee

These procedures supplement those in the *Comptroller's Handbook for National Trust Examiners* and are intended only to guide examiners during the evaluation of the trustee's role in the securitization process

57. Determine whether all indentures and contracts have been reviewed by appropriate legal counsel Establish whether the agreements have been carefully worded to specify only services that the bank is capable of performing

58 Review how bank management evaluates proposed customers and transactions that involve the bank as trustee. At a minimum, an evaluation should consider:

   a. The bank's capacity to perform all the tasks being requested

   b. The financial and ethical backgrounds of the customer.

   c The reputation and financial risks of entering into a relationship with the customer or acting as trustee for the transaction.

59 Review conflicts of interest that could arise when the bank trustee acts in an additional capacity in the securitization process If the potential for conflicts of interest is apparent, determine whether the bank's legal

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counsel has reviewed the situation and rendered an opinion on its propriety

60 Determine whether the audit of trust work on securitized products is adequate

Liquidity Enhancement Provider

61 Review agreements in which the bank agrees to provide back-up liquidity (either as a servicer or third-party provider of liquidity enhancement), and determine whether liquidity will be provided in the event of credit problems. Consider whether:

a The bank (as liquidity provider) is required to advance for delinquent receivables.

b. The liquidity agreements cite credit-related contingencies that would allow the bank to withhold advances.

62. If the bank, in agreeing to provide back-up liquidity, assumes any risk of loss that would constitute providing recourse, ensure that appropriate risk-based capital is maintained by the bank.

Underwriter and Packager

63. Determine whether legal counsel has been used in arriving at appropriate policies and procedures governing due diligence and disclosure to investors

a. Ascertain whether the bank's policy or practices require the bank to inform customers that nonpublic information in the bank's possession may be disclosed as part of the underwriting process. If not, determine whether legal counsel concurred with the decision not to provide the disclosure and ensure that the rationale behind it has been documented

b. Determine whether the bank has procedures to disclose all material information to investors.

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c. Determine whether the bank has procedures to ensure that:

- Publicly offered securities are registered under the Securities Act of 1933; or
- Any reliance upon an exemption from registration (privately offered securities are exempt from such registration) is supported by the opinion of counsel.

64 Evaluate the measures taken to limit the bank's exposure in the event that an issue the institution has agreed to underwrite cannot be sold. Review systems used to quantify underwriting risks and to establish risk limits. Consider:

- Funding capacity necessary to support temporary and long-term inventory positions;
- Balance sheet compatibility;
- Diversity of customer sales base and prospects for subsequent sale; and
- Hedging strategies.

65. Ascertain whether the bank is prepared to make a market for all asset-backed securities that it underwrites Also, determine whether this question is addressed in the bank's contingency funding plan.

66. Determine whether the bank monitors securities it has underwritten and adjusts funding plans according to noted or perceived market shifts and investor actions

67. Review the bank's files for current information on the asset-backed security originator, credit enhancer, and other pertinent parties. Assess the ability of these parties to meet their obligations.

Overall Conclusions

68. Prepare a summary memorandum detailing the results of the asset securitization examination Address the following:

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a. Adequacy of risk management systems, including the bank's ability to identify, measure, monitor, and control the risks of securitization.

b. Adequacy of the strategic plan or business plan for asset securitization.

c. Adequacy of policies and operating procedures and adherence thereto

d. Quality and depth of management supervision and operating personnel

e. Adequacy of management information systems.

f. Propriety of accounting systems and regulatory reporting.

g Compliance with applicable laws, rulings, and regulations

h. Adequacy of audit, compliance, and credit reviews

I. Recommended corrective action regarding deficient policies, procedures, or practices and other concerns.

j. Commitments received from management to address concerns.

k. The impact of securitization activities on reputation risk, strategic risk, credit risk, transaction risk, liquidity risk, and compliance risk.

l. The impact of securitization activities on the bank's earnings and capital.

m. The bank's future prospects based on its finances and other considerations.

n. Other matters of significance.

69 Discuss examination findings and conclusions with the EIC. Based on

this discussion, set up a meeting with bank management to share findings and obtain any necessary commitments for corrective action.

70. Write a memorandum specifically setting out what the OCC needs to do in the future to effectively supervise the asset securitization function. Include time frames, staffing, and workdays required

71 Update the examination work papers.

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Regulations

12 CFR 3, Minimum Capital Ratios; Issuance of Directives (including Appendix A)

Issuances

Banking Circular 177, "Corporate Contingency Planning"
Comptroller's Handbook, "Capital and Dividends"
Comptroller's Handbook, "Mortgage Banking"
Comptroller's Handbook for National Bank Examiners, "Funds Management," Section 405
Consolidated Reports of Condition and Income (the Call Reports)
Financial Accounting Standard 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"
OCC 96-52, "Securitization — Guidelines for National Banks"

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Comptroller of the Currency
Administrator of National Banks

Credit Card Lending

Comptroller's Handbook

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Assets

EXHIBIT B

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Background

The credit card has evolved over the last thirty years into one of the most accepted, convenient, and profitable financial products. It is accepted by millions of consumers and merchants worldwide as a routine means of payment for all varieties of products and services. The rapid growth of the credit card industry evidences the card's value to the financial community, including consumers, merchants, and issuing banks

Credit cards play a role in the strategic plans of many banks – either as a card issuer, merchant acquirer, or an agent bank. Issuing banks are directly involved in the credit card business through the actual issuance of cards as a member of an interchange system. Issuing banks also hold or sell the credit card loans and, therefore, bear some credit risk A merchant or acquiring bank is an entity that has entered into an agreement with a merchant to accept deposits generated by credit card transactions. Processing merchant sales drafts may result in customer charge backs and, therefore, result in some transaction risk to the merchant bank. An agent bank is a bank that has entered into an agreement to participate in another bank's card program, usually by turning over its applicants for credit cards to the bank administering the program and by acting as a depository for merchants.

This booklet discusses the operations of issuing banks It provides guidance for examiners and banks regarding the types of elements usually found in systems maintained by prudent bankers. Specific items identified for inclusion in bank policies, procedures, and guidelines are not presented as a required checklist. Each bank and its systems will vary. Examiners and bankers should consider the circumstances of the individual bank to determine what system elements are essential.

The dynamics of today's credit card market make it necessary for the successful issuing bank to manage every aspect of the lending process. In the past, success may have just happened, but with today's strong competition from other issuers, including nonbanks, and rapidly changing technologies, every step in the lending function is crucial to maximizing profits. This booklet discusses each segment of an issuing bank's credit card operation, from marketing and account acquisition to collections Each section has

Overhead expenses tend to be higher in credit card operations than in other areas of a bank The small size of individual accounts and the high transactional volume create higher costs per account Because in-house data processing costs are expensive, many operations chose to contract their processing to third-party processors.

Cost of funds is a major expense item, making up nearly half of an issuer's total expense distribution, and varies depending on the funding sources used by the bank A bank's cost of funds also will depend upon its condition and reputation in the market Many large credit card issuers use securitization as a source of funding. The examiner should discuss trends in funding costs and composition with the bank and investigate unusual variances.

In reviewing income and expense categories, it is helpful to compare the bank's performance against peer averages. The examiner should inquire whether the bank has recent industry cost studies The bank card associations periodically provide their members with cost studies and other industry data.

Securitized Assets

The securitization of receivables is an important funding vehicle for some credit card issuers Securitization is the pooling of assets with similar characteristics into a standard format for sale to investors. With regard to credit cards, the issuer sells receivables (not the accounts) to a trust while retaining an interest in a portion of the pool Certificates representing the vast majority of the pool, usually 80 percent to 90 percent, are then sold to investors as asset-backed securities (ABS).

Asset securitization can offer the following advantages:

- Provide an alternative source of funding.
- Remove assets from the balance sheet for assets sold without recourse, which improves capital ratios and certain performance ratios and possibly reduces reserve requirements
- Reduce exposures to credit and interest rate risk.
- Improve the liquidity and marketability of the securitized assets

- Allow the bank to receive regular servicing, residual (excess servicing), and other fee income.

To attract investors, securitized transactions typically must be supported by credit enhancements that protect the investor if portfolio performance fails to meet predetermined levels. Appropriate enhancements allow the security to obtain a "AAA" rating at origination. The exception is securities with a senior/subordinate structure, in which the subordinate portion usually has a lower rating, unless it is heavily enhanced. Credit enhancements can include a spread account, letter of credit, cash collateral account, or subordination agreement. (See the glossary for definitions of these terms.)

The credit enhancement for a securitization primarily provides protection for the investors, but also normally gives the examiner information about the market's view of the bank's credit card operations. An overall increase in the amount of credit enhancement needed to bring a securitization to market may indicate that the market perceives some weakness in underwriting, collections, fraud control, or servicing capabilities. Credit enhancement is most often in the form of subordinated classes of securities, supplemented with cash collateral and spread accounts. To assess market perception, the examiner may compare the relative amount of credit enhancement that was necessary to get a "AAA" rating for the most senior piece of a multi-level securitized transaction, with past securitized issuances by the same bank and other issuers' current deals.

ABS are usually structured to pay interest only during a revolving period, followed by an amortization period. During the revolving period, the investors' principal portion remains at a fixed level. The originator's (issuing bank) interest in the pool fluctuates since it serves as a buffer to keep the investor portion at a fixed level. All principal payments from card holders are paid from the trust to the originator and are used to purchase additional receivables. Revolving periods usually last two to seven years.

During the amortization period, cash flows received from customers are paid to investors and the originator based on their pro rata ownership interests. When the investors' principal portion is fully paid, the originator owns 100 percent of the receivables in the trust. Some ABS have bullet amortization structures which make a single principal payment on the maturity date. Banks

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that use securitization as a source of funding for their credit card originations often repackage the receivables at maturity for a new securitized issuance.

Most revolving credit card Master Trusts (see below) contain early amortization triggers These triggers are in place to protect the investor should the portfolio not perform at certain predetermined levels. Generally, triggers are tied to maintenance of a predetermined portfolio yield and loss rate. If a trigger is activated, the trust must begin early amortization of the security. Each series within a Master Trust may have its own specific trigger, which should be tracked by the bank's MIS reports. Depending upon the structure of the trust, individual series may go into early amortization without affecting the Master Trust.

The unexpected funding needs associated with an early amortization event can pose liquidity concerns for the originating bank The triggering of an early amortization event results in the trust immediately passing principal payments through to investors This leaves the bank, as owner of the underlying accounts, responsible for funding new charges that would normally have been purchased by the trust. Banks should have liquidity contingency plans which address this potential unexpected funding requirement. Management should receive and review MIS reports showing the performance of the securitized portfolio in relation to the early amortization triggers.

Many large credit card issuers began securitizing receivables under a Master Trust structure in 1988. In a Master Trust structure, several issues or series share the rights to a common pool of receivables. As long as certain conditions are satisfied, a bank can issue multiple series out of the same Master Trust, simultaneously or over a period of time

Series in the same Master Trust can have different cash flow structures, maturities, early amortization events, credit enhancement levels, ratings, and principal repayment mechanisms. Some structures also provide for a Master Trust to be subdivided into groups of series to interconnect some series, or to limit the effect of some series to that group.

Unlike the stand-alone trust structure in which receivables from selected accounts are assigned for the life of the trust, most Master Trust agreements allow card-issuing banks to assign additional receivables to the trust In addition to adding receivables when a bank issues a new series, a bank may add receivables to

replace those balances lost to card holder attrition or maintain the characteristics of the existing pool. Some Master Trust agreements permit limited lump sum additions without notifying the ratings agencies An issuer also may be required to add or remove receivables to maintain a minimum prescribed level.

The bank should have comprehensive policies and procedures addressing asset securitization These policies should address required approvals, selection of assets, and initial and ongoing reporting requirements Bank management should periodically report to the board of directors on the performance of securitized assets

The bank also should have a plan for servicing securitized assets. The examiner should determine whether the bank's current systems, including staffing, are capable of handling the requirements for the current and anticipated securitization volume. The bank's failure to adequately service the portfolio could trigger an early amortization event.

Bank MIS should provide a summary of initial terms and ongoing performance of its securitizations The examiner should review the terms of each securitization and analyze associated risks, focusing on the pricing and credit enhancements of the securitization. For example, a securitization with a fixed coupon payment exposes the bank to future interest rate risk, but allows management to plan its cash flows with certainty. Conversely, a securitization with a floating rate coupon means that the bank limits appreciable interest rate risk, but is potentially exposed to future liquidity risk.

Income Analysis for Securitized Assets

Securitization changes the composition of the institution's income. On a nominal basis, the result is less interest income and more fee-based income. Examiners must realize, however, that securitization does not change the true operating performance of the retail lending portfolio

Securitizations must be included in any review of the portfolio's earnings and asset quality. For example, prior to the securitization, a bank's portfolio might show a 2 percent pre-tax return on assets After securitization, when the return is calculated on the new, smaller asset figure, it appears higher (for example, it might move from 2 percent to 5 percent). The dollar income generated, however, remains unchanged. An assessment based on the

portfolio net of securitized assets is an inaccurate indicator of performance A more appropriate way to analyze return would be to look at the performance of all assets under management.

Reviews of asset quality and collection efforts, including reaging and fixed payment programs, should include the securitized portfolio. Aggressive reaging or other collection programs could understate delinquency rates and charge-offs, and misrepresent the portfolio's performance to the investors. Buying back problem loans may constitute recourse on the transaction for the issuer/originator. Under current regulatory accounting procedure, recourse transactions are accounted for as financings rather than sales, placing more stress on the bank's capital structure

Generally accepted accounting procedure (GAAP) currently prescribes a different reporting treatment than regulatory accounting procedure (RAP) for securitization profit. Under RAP, an issuer may not book profits for securitizations at origination by applying present value standards to the expected income from the spread account, a treatment acceptable under GAAP. RAP treatment does not allow a bank to report as income monthly payments to the spread account that exceed the cost of servicing until investor claims are extinguished. On the other hand, under GAAP, the bank may report any excess service fees as income over the life of the security

On January 1, 1997, RAP will conform with GAAP on securitization profits. Until that time, the examiner should analyze the effects of these GAAP/RAP differences on current and future RAP earnings. More information on GAAP and RAP accounting can be found in Financial Accounting Standard (FAS) 77 (changes to FAS 125 on January 1, 1997) and the Instructions to the Consolidated Reports of Condition and Income issued by the FFIEC.

Purchased Credit Card Relationships

Purchased credit card relationships (PCCRs) are intangible assets that are created when a bank acquires a credit card portfolio at a premium from a third party. Generally, Visa/MasterCard portfolios are purchased at a premium, usually 10 percent to 25 percent over outstanding receivables; the amount over the par value (the premium) of the portfolio is the PCCR. The cost of acquiring a private label portfolio varies widely and may even be made

at a discount. Management may elect to divide the PCCR into different categories, such as non-compete, loan loss, yield adjustment, and goodwill. The purchase price can be determined by a variety of factors that, in aggregate, drive the cash flows of the portfolio. Some of the main factors considered are the yield, attrition rates, charge-off rates, funding rates, and processing costs.

Most credit card portfolio purchasers maintain automated software models that management can load with its best estimates of how the proposed portfolio will perform. This data is obtained from the brokers and/or sellers and will be used to determine the initial bid on the portfolio. If the bank is selected to perform a due diligence exam (because it offered one of the highest bids) it will then modify the model with enhanced data obtained from the due diligence exam. The model will generally create cash flow data, income statements, balance sheets, equity flows, etc. that will permit the purchaser to determine an appropriate value to place on the portfolio, usually based upon an internal earnings hurdle rate. Models typically used include discount cash flow models, discounted capital flow models, and return on asset models. (See Appendix E for a detailed discussion of how to analyze purchased credit card relationships.)

Glossary

Acquirer, acquiring member, or merchant bank. A bank, financial institution, or other MasterCard or Visa member that maintains the merchant relationship and receives all credit card transactions; sometimes referred to as the acquiring bank.

Affinity card. A credit card issued by a bank in conjunction with an organization or collective group; for example, profession, alumni, retired persons association. The card issuer often pays the sponsoring organization a fee.

Agent bank. A bank that, by agreement, participates in another bank's card program, usually by turning over its applicants for bank cards to the bank administering the card program and by acting as a depository for merchants.

Cash collateral account. This is a credit enhancement common in asset-backed security structures The cash collateral account is held in a segregated trust account, funded at the outset of the deal, and can be drawn on to cover shortfalls in interest, principal, or servicing expense for a particular series if the excess spread is reduced to zero

CEBA bank. This is a special kind of issuing bank. The term CEBA bank comes from enactment of the Competitive Equality Banking Act of 1987 (CEBA), which established conditions for special-purpose credit card banks. CEBA banks may only accept time and savings deposits of $100,000 or more They typically have a nonbank holding company parent They are often affiliated with a retailer and offer private label cards for use at the affiliated organization They may, however, issue a general purpose Visa or MasterCard instead.

Champion/challenger strategy. Management applies one strategy against a portion of the portfolio (champion) and other strategies (challengers) against additional segments of the portfolio to identify a more successful practice.

Chargeback. A dispute procedure initiated by the card issuer after receipt of the initial presentment from the acquirer. The issuer may determine that, for a given reason, the transaction was presented in violation of the rules or procedures and is eligible to be returned to the acquirer for possible remedy.

Cobranded card. A card issued by a bank bearing the logo and name of another company that has a commercial purpose. There is usually some type of rebate or added benefit for the consumer

Convenience user. A card holder who pays the balance in full on each payment due date

Corporate card. A card issued to companies for use by company employees. The liability for abuse of the card typically rests with the company and not with the employee

Credit card. A plastic card used to purchase goods and services and to obtain cash advances on credit, for which the card holder is subsequently billed by the issuing institution for repayment of the credit extended.

Credit scoring. A statistical method for predicting the creditworthiness of credit applicants.

Independent sales organization (ISO). An outside company contracted by banks to administer merchant and/or card holder servicing

Interchange rate. The fee extracted from the discount fee paid by the merchant who accepted the credit card transaction. Interchange fees are set by the bank card associations (MasterCard and Visa) based upon the size and method of transmission from the merchant.

Issuer. The institution (or its agent) that issues the card to the cardholder, sometimes, referred to as the issuing bank

Letter of credit (LC) This is a type of guarantee provided by a third party. On most securitizations, the LC is a second layer of enhancement, after a spread account. LCs are less attractive enhancements because they depend on the financial standing of the issuing bank If that bank is downgraded by the ratings agencies, the securitized issue also is likely to be downgraded.

Merchant authorization. The means of receiving sales validation for the merchant, by telephone or authorization terminal, to guarantee payment to the merchant.

Periodic rate. An amount of finance charge expressed as a percentage that is to be applied to a credit card loan balance for a specified period, usually monthly.

Point-of-sale (POS). The location where a customer makes a purchase from a merchant.

Reaging (also curing or rollback). The practice of bringing a delinquent account current.

Rollover. The practice of carrying forward a portion of an outstanding balance on a cardholder's account from month-to-month

Securitization. The process of creating an investment security backed by credit card receivables.

Settlement. The process by which acquirers and issuers exchange financial data and value resulting from sales transactions, cash advances, merchandise credits, etc.

Spread account. This is the most common form of a securitization credit enhancement. It is a reserve account that absorbs credit losses. The spread account generally equals two to three times the expected losses in the package of receivables. This spread account is initially "seeded" (funded) by the selling bank. These advances are usually expensed to achieve regulatory accounting procedure (RAP) sale treatment. Excess servicing income is deposited into this account each month until it is fully funded and the seed money is repaid to the selling bank. The account is controlled by the trustee.

Subordination agreement. This is another securitization credit enhancement arrangement that identifies senior and subordinated portions of the security issue. The enhancement is to the senior portion, which gains payment priority in terms of amortization and in the event of liquidation.

Third-party processing. The processing of transactions by parties acting under contract to card issuers or acquirers

Vintage. The year of origin of a cardholder's account

16. Review internal reports on overlimit activity to verify that they include the percentage of accounts in an overlimit status as well as the percentage of dollars in the portfolio in an overlimit status.

17 If overlimit amounts are significant or if negative trends are evident, discuss with management Determine whether the level of overlimit accounts reflects effective control of transaction authorization and credit risk in general. Make recommendations for improvement if appropriate

18 Evaluate the overall adequacy of transaction authorization procedures and the effectiveness of such procedures for controlling credit risk. Discuss with management compliance with authorization guidelines.

Collections

1. Assess the structure, management, and staffing of the collections department. If not previously performed under the "Management and Organization" section:

   - Review the department's organization chart and discuss staffing plans with senior management

   - Review the experience levels of senior managers and supervisors

   - Discuss with management how supervisors manage their collectors and evaluate the ratio of collectors to supervisors.

   - Determine how often supervisors review collectors' performance, and review the criteria used for evaluation.

2. Assess the adequacy of the bank's written collection policies and procedures by ensuring that it sufficiently covers all necessary activities.

3 Assess the appropriateness of management's collection strategies by:

   - Reviewing the method management uses to ascertain the effectiveness of its collection strategies

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- Determining who has authority to revise collection strategies after evaluating the conditions under which strategies may be changed.

- Evaluating how accounts are distributed to the collectors.

- Reviewing the number of accounts collectors handle on average, analyzing how this level is established, and determining whether it is appropriate.

- Establishing whether the bank uses behavior scoring or any other predictive techniques to assist in the collection of accounts. If so, determine:

  – Who built the system(s).
  – How the collections department uses the system(s).
  – When the system(s) was last revalidated and by whom.

- If applicable, determining when the behavior scoring or other predictive systems trigger into a champion/challenger program (adaptive control). Specifically:

  – Determine who built the program(s).
  – Assess the adequacy of the policies and procedures governing the use of the program(s).
  – Ensure that the bank's controls provide for properly testing a challenger strategy before a decision is made to replace the current champion strategy.

4. Determine the conditions under which the bank imposes a late fee on a delinquent account, its amount, and that the bank does not pyramid late fees.

5. Determine the delinquency level at which the bank temporarily suspends further purchasing activity and the level at which it closes an account permanently Specifically:

   - Evaluate the circumstances under which a closed account can be reactivated, and verify that the collections department refers such accounts to the credit department for a decision

- Determine whether behavioral scoring models generate or contribute to decisions to permanently cancel or temporarily suspend account activity If so, assess the specific scoring ranges associated with each block.

6 Evaluate the various collection programs used, such as reaging, fixed payment, CCCS, and forgiveness Specifically:

   - Ascertain the collection programs in place and planned through discussions with management

   - Evaluate the policies and procedures and verify that management adequately monitors and analyzes the performance of each program.

   - Assess the current and potential impact of such programs on the bank's reported performance and profitability, including allowance implications.

7 Review the bank's "skip tracing" practices and procedures to keep track of delinquent customers and determine their effectiveness by:

   - Ascertaining what portion of the portfolio lacks current telephone numbers and mailing addresses

   - Determining whether the bank can monitor an outside agency used to skip trace accounts, if applicable.

8. Assess the adequacy of the automated systems used by the bank to collect delinquent accounts and discuss these systems with management. Determine:

   - Which automated collections systems the bank uses, how each system is used, and key MIS reports generated by and for each system.

   - That they provide sufficient data to allow collectors to make appropriate decisions

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- Whether systems generate a sufficient audit trail.

- Whether contingency plans are in place in the event of a temporary power outage or a disaster, and determine that the plans are tested on a regular basis.

- If power-dialing is used to contact delinquent account holders, determine how the system routes "no contact" accounts

9. Assess the effectiveness of the bank's overall collection strategies and the systems used to collect accounts. Consider whether such strategies are appropriate given the size and complexity of the operation, the bank's previous collection history, and its future marketing strategies

10 Evaluate the adequacy of the bank's charge-off policy by:

   - Ensuring that it meets OCC and interagency policy.

   - Reviewing the processor's user manual to verify that the charge-off parameters correspond to those described in the bank's charge-off policy If not, discuss the differences with management and request appropriate corrective action

   - Determining how accounts scheduled for charge off are loaded into a charge-off queue or other system for loss Specifically:

     – Determine the circumstances, if any, which will delay an account charge-off
     – Determine whether the bank takes losses daily, weekly, or monthly.

   - Ensuring that a payment of less than 90 percent of a full payment triggers advancement of the account to the next delinquency category. (This does not apply to fixed payment or workout program accounts for which the bank formally renegotiates terms.)

11 Determine what systems the bank uses to recover charged-off accounts and determine whether these systems interface with the bank's collection management system.

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- If not, discuss how information is transferred from the collection management system to the recovery system
- If the information is not transferred, assess how the recovery unit gathers and uses information about prior collection activities

12 Determine whether the bank uses outside collection agencies to recover accounts. If so:

- Evaluate the systems and controls used to supervise out-placed accounts
- Determine the frequency and how the bank rotates accounts between collection agencies
- Determine how the bank monitors the success of collection agencies to ensure it is placing accounts with productive firms in the most cost-effective manner.

13. Determine whether the bank uses legal firms to recover accounts. If so:

- Determine what conditions trigger a referral to a legal firm.
- Determine how the bank decides which firms to use.
- Evaluate the systems and controls used to supervise accounts referred to legal firms
- Evaluate the costs associated with the use of legal firms.

14 Evaluate the bank's recoveries as a percentage of prior period losses by:

- Evaluating the accuracy of the figures.
- Determining whether recoveries fall within reasonable tolerances based on industry averages If not, discuss with management and determine why recoveries were low.

15 Assess the quality, accuracy, and completeness of MIS reports and other analyses used to manage the collections process. Specifically:

- Evaluate the quality of MIS collection reports provided to executive management on a regular basis, and determine whether the reports provide adequate data upon which to base informed decisions.

- Determine the appropriateness and accuracy of key collection reports.

16. Assess the appropriateness of the bank's incentive pay program for collectors. Pay particular attention to possible negative ramifications of such a plan (e.g., encourages protracted repayment plans, leads to aggressive reaging, or promotes individual rather than team efforts among the collectors) Specifically:

- Evaluate how the program is administered

- Determine whether the board or senior management reviewed and approved the incentive pay program in advance.

- Determine whether the plan limits the total incentive pay a collector may receive

- Determine whether the bank compensates its collectors for placing accounts in various workout or fixed payment programs. If so, evaluate such activities for prudence.

17. Assess the adequacy and effectiveness of the bank's training program for collectors by:

- Reviewing a copy of the training manual, on-the-job training programs, and supervisory follow-up and monitoring.

- Discussing alternative means of training with management. If the bank's circumstances warrant a more formal training process, make appropriate recommendations.

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18. Assess the adequacy of audit and review in the collections area (i e , scope, frequency, timing, report content, and independence), and management's response to previous deficiencies identified by:

   - Reviewing the most recent audits (internal and external) as well as pertinent reports submitted by loan review and/or bank consultants.

   - Evaluating the adequacy and timeliness of management's response to any significant issues dealing with accounting, policies and procedures, or collections programs disclosed in these reports. If necessary, test corrective action.

   - Discussing any necessary audit enhancements with management and the loan portfolio management (LPM) examiner.

19. Determine whether the bank is considered a debt collector as defined by the Fair Debt Collection Practices Act. If so, submit a memo to the EIC to ensure appropriate review at the next compliance examination

Fraud Control

20. Review the organization chart for the fraud control department and evaluate the quality and depth of the staff based on the size and complexity of the issuer.

21. Review MIS reports pertaining to fraud control Determine:

   - The usefulness of the information presented.

   - The level of fraud losses as compared with industry averages.

22. Assess appropriateness of fraud policies by determining:

   - Whether possible fraud accounts are reaged before investigation

   - When fraud losses are realized

   - How fraud losses are taken (miscellaneous expense)

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- Processing of incoming interchange.
- Card holder billing.
- Payment processing
- Card holder servicing and promotion
- Overlimit and collections
- Issuer fraud investigation
- Card holder authorizations.
- Issuer center administration.

18. Review management's provision for loan losses and determine whether the provision provides an adequate allowance for loan losses.

19. Determine what, if any, corporate overhead is allocated to credit card operations and whether the level is appropriate.

20. Compare financial results against those reported by the industry and, if significantly different, determine causes.

Securitized Assets

1. Review the bank's asset securitization policy

2. Review reports detailing each outstanding securitized issuance and those in the pipeline.

    - Determine significant terms of each securitized issue.
    - Evaluate the current level and trends in the securitization process.
    - Discuss with management its future expectations for additional securitized issuances.

3. Evaluate the performance of securitized issuances, and compare performance against early amortization triggers. Discuss significant trends in performance with management.

4. Discuss with management the collection policies applied to the securitized portfolio. Evaluate the impact of collection programs, such as reaging, on performance reports to investors

5. Review the terms of the securitization agreements to identify practices that may create liability or recourse on the bank's part. This might include preference to investors or credit enhancers in the receipt of payments.

6. Discuss with management how the bank determines accounting treatment for securitized assets.

7. Determine whether the bank routinely repurchases past due loans from the securitization If so, the examiner should investigate the recourse implications and recourse accounting policy (financing versus sales treatment).

8. Discuss with management the bank's plan to fund securitized assets upon maturity.

9. Discuss with management its planning process to ensure adequate systems for servicing current and anticipated securitizations.

10. Evaluate the adequacy of management information systems for the securitization process at both the board and management level.

Purchased Credit Card Relationships

1. Determine whether the bank has booked any purchased credit card relationships (PCCR). If so, discuss the modeling process with bank personnel. Review their latest quarterly valuations for appropriateness. If any impairment exists, discuss with EIC and management to determine appropriate action. Do not request a write-down without the specific authorization of the EIC. If no PCCRs are booked, document in work papers.

The following questionnaire may be used to review and document the bank's internal controls, policies, practices, and procedures for credit card operations. Where appropriate, documentation may include narrative descriptions, flowcharts, copies of forms used, and other pertinent information.

Yes No

Policies

1. Has the board of directors, consistent with its duties and responsibilities, adopted written policies that established:

   - Procedures for reviewing credit card applications?
   - Standards for determining credit lines?
   - Minimum standards for documentation?
   - Standards for collection procedures?

2. Are policies reviewed at least annually to determine that they are compatible with changing market conditions and the bank's strategic plan?

Underwriting and Scoring Models

3. Does audit and/or internal loan review test compliance with underwriting standards?

4. Are underwriting standards periodically reviewed and revised?

5. If credit scoring models are used:

Yes No

- Are credit limits determined by cutoff scores?
- Are models periodically revalidated?
- Are there internal procedures governing overrides?

6 Is data from the application tested for input accuracy to the account processing system? If so, what is the sample size and frequency of the test?

7. Are line of credit increases reviewed periodically by an independent person to determine compliance with bank policy and procedures?

8. Are credit lines periodically reviewed by an independent person for appropriateness of amount?

9 Are procedures in effect to review credit lines when the bank becomes aware of a change in financial status or creditworthiness of a cardholder?

10 Is an exception report produced and reviewed by management that includes credit card extensions, renewals, or other factors which would result in a change in customer account status?

11. Are records of issued cards balanced daily to the report total of new and reissued cards?

12 Does the bank have procedures covering the establishment of employee accounts?

13. Are employee accounts periodically reviewed?

14. Has the bank established a policy on cash advances to employees?

Yes No

15. Is the information on fraud claims reviewed to determine whether:

    - A bank employee could have been involved?

    - A breakdown in the bank's control of issued cards is indicated?

    - The card could have been abstracted before it left the bank?

16. Are signatures on sales drafts compared to signatures on notifications by owners of cards disclaiming knowledge of sale or loss of card?

17. Is an officer required to sign off on the conclusion of a fraud investigation?

18. Does the credit card operation prepare a budget by:

    - Function (e.g., collections, application processing)?

    - Program (e.g., secured card, private label)?

    - Overall operation?

19. Are actual results compared to budget at least monthly?

20. Are significant trends and deviations adequately explained in the financial review process?

21. Do asset securitizations receive appropriate approval?

Yes No

22 Are collection programs for securitized loans appropriate?

23. Does management have a plan to ensure adequate funding for maturing securitizations?

Risk Management

24. Does management develop and maintain underwriting and account management guidelines?

25 Does management monitor adherence to those guidelines?

26 Does management ascertain the quality of the portfolio and assign risk ratings?

27 Does management periodically review policies and procedures for adequacy and assess their impact on portfolio quality?

28 Does management ensure the integrity of scoring systems and other models in use?

Conclusion

Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures).

Based on a composite evaluation, as evidenced by answers to the foregoing questions, internal control is considered ___ (good, medium, or bad)

1998 WL 667884 (O.C.C.)

(Cite as: 1998 WL 667884 (O.C.C.))

Office of the Comptroller of the Currency (O.C.C.)

Corporate Decision

*1 Corporate Decision No. 98-39
March 27, 1998

DECISION OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY ON THE CONSOLIDATED NOTICE AND APPLICATIONS OF CITICORP AND CITIBANK, N.A., NEW YORK, NEW YORK, UNDER THE CHANGE IN BANK CONTROL ACT AND UNDER 12 C.F.R. § 5.34, TO INDIRECTLY ACQUIRE UNIVERSAL BANK, N.A., COLUMBUS, GEORGIA, AND TO ACQUIRE AND ESTABLISH AT & T UNIVERSAL CARD SERVICES CORP. AND ITS SUBSIDIARIES AS OPERATING SUBSIDIARIES OF CITIBANK, N.A.

I. INTRODUCTION

On January 12, 1998, Citicorp and its principal subsidiary, Citibank, N.A., New York, New York ("Bank") filed a consolidated notice with the Office of the Comptroller of the Currency ("OCC"), pursuant to the Change in Bank Control Act ("CBCA"), 12 U.S.C. § 1817(j), and applications pursuant to 12 C.F.R. § 5.34, to acquire AT & T Universal Card Services Corp. ("CSC") and its subsidiaries, collectively "UCS", from AT & T Corp ("AT & T"). The Bank proposes to establish CSC as a direct operating subsidiary. The acquisition of CSC includes the indirect acquisition of Universal Bank, N.A., Columbus, Georgia, currently a second tier subsidiary of CSC.

The Bank is the principal subsidiary of its sole shareholder, Citicorp, a multi-state registered bank holding company, incorporated in Delaware. Citicorp is the largest issuer of credit cards in the U.S., with approximately 25 million accounts in the U.S. and approximately 36 million worldwide. It has approximately $46 billion in managed credit card receivables in the U.S. and approximately $55 billion worldwide. Citicorp currently operates its U.S. credit card business through multiple bank and non-bank affiliates. Citicorp's credit cards (MasterCard, VISA and Diners Club) are issued by Citibank (South Dakota), N.A., Sioux Falls, South Dakota.

CSC wholly owns three Delaware-incorporated direct non-bank subsidiaries, AT & T Universal Bancorp, Inc. ("Bancorp"), a holding company for depository institution subsidiaries, AT & T Universal Funding Corp. ("Funding"), a company engaged in securitization of receivables, and AT & T Universal Bancorp Services, Inc. ("Services"). Bancorp wholly owns Universal Bank, N.A., Columbus, Georgia ("Georgia Bank"), a national CEBA credit card bank, and AT & T Universal Financial Corp., Salt Lake City, Utah ("Utah Bank"), a Utah state-chartered industrial loan

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company.

Services holds a 10 percent interest in both Mondex USA Services LLC and in Mondex USA Originator LLC ("Mondex LLCs"), two Delaware limited liability companies that have been established to implement the Mondex electronic stored value ("ESV") system in the United States. Mondex USA Originator LLC was established to create, sell and redeem Mondex ESV in exchange for dollars. Mondex USA Services LLC was established to act as a licensing and servicing entity for the Mondex USA services. Services also holds a 3.1 percent interest in Mondex International Limited ("Mondex International"), a U.K. company with limited liability that holds the rights to the Mondex concept and has authority to license institutions in various countries to develop and operate Mondex in their various countries.

*2 Georgia Bank had $49.5 million in assets and capital of $5.3 million as of September 30, 1997. Its activities are limited to the issuance of credit card accounts and loans for personal, family or household use. It does not engage in the business of making commercial loans. Georgia Bank has only a single office that accepts deposits. It does not accept demand deposits or deposits that the depositor may withdraw by check. It accepts only savings and time deposits of $100,000 or more. Accordingly, Georgia Bank is not regarded as a "bank" for purposes of the Bank Holding Company Act. 12 U.S.C. § 1841(c)(2)(F); 12 C.F.R. § 225.2(b)(2). Georgia Bank issues primarily MasterCards. The majority of AT & T Universal Card accounts issued as VISA cards have been issued by an unrelated bank pursuant to an affinity agreement. Citicorp intends to continue to issue the AT & T Universal Card through Georgia Bank

Utah Bank had approximately $97.1 million in assets and capital of approximately $16.6 million as of September 30, 1997. Its deposits are insured by the Federal Deposit Insurance Corporation. Utah Bank does not accept demand deposits. Utah Bank's business includes the issuance of AT & T Universal Business Cards to corporate customers. The Bank intends to continue the business conducted by Utah Bank, including the issuance of the MasterCard business credit card. However, the Bank plans to divest Utah Bank's industrial loan company charter either by sale within six months of consummation of the acquisition of CSC or by transfer to Citicorp within such time period.

As required by 12 C.F.R. § 5.50(g), the Bank published notice of its proposed acquisition of Georgia Bank, in which public comment was solicited. The notice was published in newspapers of general circulation in the cities in which the Bank and Georgia Bank are located. No comments were received.

II. LEGAL AUTHORITY

A. Review under the Change in Bank Control Act

Under the CBCA, no person may acquire control of any insured depository institution through a purchase, assignment, transfer, pledge, or other disposition

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of voting stock unless the appropriate Federal banking agency has been given sixty days' prior written notice of such proposed acquisition and within that time the agency has not issued a notice disapproving the proposed acquisition. 12 U.S.C. § 1817(j). Under the standards set forth in the CBCA and in 12 C.F.R. § 5.50, the OCC may generally disapprove a change in bank control notice if the transaction would result in a monopolistic market share or be in furtherance of any combination or conspiracy to monopolize the business of banking in the United States, the effect of the transaction would be to substantially lessen competition, the financial position of the acquiror is such as to jeopardize the financial stability of the bank or prejudice the interests of depositors, the competence of the acquiror or the proposed management indicates that it would not be in the interest of the public or the bank's depositors for the transaction to proceed, the acquiror fails to furnish all the information required, or the transaction would affect the insurance funds adversely. See 12 U.S.C. § 1817(j)(7) and 12 C.F.R. § 5.50(e)(4). [FN1]

*3 For the following reasons, we find no objection to the change in bank control under section 1817(j). The OCC has analyzed the financial condition of the Bank, including its most recent reports of condition and income. The Bank had $254 billion in consolidated total asset worldwide, as of September 30, 1997 and is the largest credit card issuer in the United States. The Bank's financial condition is consistent with a decision not to disapprove the change in bank control. The OCC has also considered the competence, experience and integrity of the management and other personnel of the Bank and the proposed management of Georgia Bank and has found no information to support a disapproval of the notice on those grounds. Further, the OCC is satisfied that the Bank has furnished all information that the OCC has required and that the proposed transaction would not result in an adverse effect on the insurance funds. Additionally, the OCC has determined that the transaction would not result in a monopoly or be in furtherance of a combination or conspiracy to that end and that the effect of the transaction would not be such as to substantially lessen competition or tend to create a monopoly or in any other manner be in restraint of trade. The OCC notes that the Department of Justice ("Department") has reviewed a notification pertaining to this transaction filed by the Bank and AT & T under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a, and that the Department has not acted within the statutory waiting period to prevent the transaction from proceeding.

B. Review under 12 C.F.R. § 5.34

A national bank may establish or acquire an operating subsidiary to conduct activities that are part of or incidental to the business of banking, and other activities permissible for national banks or their subsidiaries under other statutory authority. See 12 U.S.C. § 24 (Seventh) and 12 C.F.R. § 5.34(d). In this regard, the activities of CSC and its subsidiaries and the minority investments they hold are consistent with approval. [FN2]

1. The activities of Georgia Bank are permissible for a national bank and the activities of each entity in the UCS family, including Georgia Bank, are

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permissible for a national bank operating subsidiary. [FN3]

Georgia Bank is organized as a CEBA credit card bank. It engages only in credit card operations, does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others, does not accept any savings or time deposits of less than $100,000, [FN4] maintains only one office that accepts deposits, [FN5] and does not engage in the business of making commercial loans. Thus, Georgia Bank conforms to the activity and business limitations set forth in section 2 of the Bank Holding Company Act, 12 U.S.C. § 1841(c)(2)(F). Utah Bank is organized as an industrial loan company. As such, it conforms to the activity limitations set forth in section 2 of the Bank Holding Company Act, 12 U.S.C. § 1841(c)(2)(H)(i)(I).

***4** The Bank's ownership of Georgia Bank and Utah Bank does not render the Bank a bank holding company under the BHCA and is otherwise permissible for a national bank. [FN6] Since Georgia Bank is a CEBA credit card bank and Utah Bank is an industrial loan company, the Bank Holding Company Act, 12 U.S.C. §§ 1841-1850 is not applicable in either case. Georgia Bank is not a "bank" for purposes of the BHCA, 12 U.S.C. § 1841(c)(2)(F) and Utah Bank is not a "bank" for purposes of the BHCA, 12 U.S.C. § 1841(c)(2)(H)(i)(I). Neither Georgia Bank nor Utah Bank will become a "bank" for the purposes of the BHCA as a result of this transaction. Thus, no party that is not already a bank holding company under federal law will become one by virtue of this transaction. [FN7]

Upon consummation of the acquisition of CSC by the Bank, Georgia Bank will continue to be a credit card issuer, soliciting and developing credit card relationships with customers throughout the United States. In addition, Utah Bank engages in business credit card lending. [FN8] Establishing credit card accounts and generating accounts receivable evidencing extensions of credit is a permissible activity for a national bank. See 12 U.S.C. § 24 (Seventh) (power "to carry on the business of banking ... by discounting and negotiating ... evidences of debt"). The OCC has chartered national banks for this purpose and has permitted Georgia Bank to engage in these activities under its current ownership. In addition, the OCC has permitted such activities to be carried out in an operating subsidiary. See Conditional Approval No. 245 (May 13, 1997). See also 12 C.F.R. § 5.34(e)(2)(ii) (referring to credit card lending as a permissible activity that qualifies for a pre-approved notice procedure for a national bank operating subsidiary). Thus, Georgia Bank and Utah Bank may conduct these credit card activities as subsidiaries of the Bank.

Following consummation of the acquisition of CSC by the Bank, and as currently, certain credit card receivables will be securitized. Securitization of credit card receivables is a permissible activity for a national bank. [FN9] The OCC has previously authorized the securitization of credit card receivables as part of the business of banking. See OCC Interpretive Letter No. 540 (December 12, 1990), reprinted in [1990-1991 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 83,252. See also Securities Industry Association v. Clarke, 885 F.2d 1034 (2d Cir.1989), cert. denied, 493 U.S. 1070 (1990) (national bank authority to securitize assets);

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Interpretive Letter No. 514 (May 5, 1990), reprinted in [1990-1991 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 83,218 (securitization of mortgages); Interpretive Letter No. 416 (February 16, 1988), reprinted in [1988-1989 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 85,640 (securitization of automobile loans); No Objection Letter No. 87-9 (December 16, 1987), reprinted in [1988-1989 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 84,038 (securitization of commercial loans originated by the bank). Thus, the Bank may engage in the activity of credit card securitization through its subsidiary, Funding. [FN10]

*5 UCS provides merchant processing services including front-end authorization, back-end settlements, collection and customer care services to AT & T in AT & T's capacity as a merchant. It will also offer this service to other merchants. The OCC has previously determined that the provision of merchant processing services is authorized under 12 U.S.C. § 24 (Seventh). See, e.g. Conditional Approval No. 255 (September 25, 1997); OCC Interpretive Letter No. 689 (August 9, 1995), reprinted in [1995-1996 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 81,004; OCC Interpretive Letter No. 720 (January 26, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 81,035 ; Banking Bulletin 92-94, Merchant Processing (May 5, 1992). Accordingly, UCS may engage in these activities.

Georgia Bank, through a subcontract with UCS, offers a billing service that combines bills from multiple companies into a single statement for holders of the AT & T Universal Cards. It also provides service to AT & T in support of AT & T's Direct Billed Card program for telecommunication customers whose service is not tied to a residence. The services provided to AT & T include account maintenance, credit and application processing, correspondence, collections statement production and remittance. The billing services in which UCS engages enable the transfer of funds between different financial accounts, either within the same financial institution or among more than one financial institutions. The transfer of funds from one account to another, or from one financial institution to another, is a fundamental part of the basic business of banking and, as such, is clearly a permissible activity. The OCC has previously held that national banks may use automated data processing to provide billing services and accounts receivable services for itself and others. See OCC Interpretive Letter No. 419 (Feb. 16, 1988), reprinted in [[1988-1989 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 85,643. Thus Georgia Bank and UCS may engage in the automated billing services described above.

2. The Bank may acquire minority investments in the Mondex LLCs

As a result of its acquisition of CSC, the Bank will acquire the interests held by CSC's subsidiary, Services, in the Mondex LLCs. [FN11] Services will continue to hold its existing equity interests in the Mondex LLCs, 10 percent of the equity of each. The OCC has previously approved indirect investments by national banks in limited liability companies through an operating subsidiary structure. Such investments are permissible if they meet the requirements for direct minority investments by national banks. One such approval pertained to the establishment of operating subsidiaries to acquire membership interests in the Mondex LLCs. See

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Conditional Approval No. 220 (December 2, 1996) ("Mondex Letter"). The filing states that the Bank will conform to the representations and descriptions contained in the Mondex Letter. It describes with details how CSC's investment in the Mondex LLCs conforms to the four standards the OCC has established with respect to a national bank's direct or indirect ownership of a non-controlling interest in a limited liability company. The Bank has also committed that its operating subsidiaries will conduct activities according to the OCC policies and guidance issued in the Mondex Letter, as well as policies and guidance issued regarding these activities. [FN12]

*6 The discussion in the Mondex Letter regarding the permissibility of non-controlling minority investments applies equally to the Bank and its present proposal. On the basis of the representations specified in the consolidated notice and applications, and any other submitted materials, the operating subsidiaries may acquire the investments in the Mondex LLCs. [FN13]

III. CONCLUSION

For the reasons set forth above, including the representations and commitments made and deemed made by Citicorp and the Bank, we find that there is no objection to the notice under U.S.C. § 1817(j) nor to the approval of the operating subsidiary applications under 12 C.F.R. § 5.34. Accordingly, the OCC hereby issues notice of its intent not to disapprove the notice under 12 U.S.C. § 1817(j) and hereby approves the applications under 12 C.F.R. § 5.34.

Julie L. Williams

Chief Counsel

FN1 The grounds for disapproval of a notice under the CBCA set forth at 12 U.S.C. § 1817(j)(7) are as follows:

(A) the proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States;

(B) the effect of the proposed acquisition of control in any section of the country may be substantially to lessen competition or to tend to create a monopoly or the proposed acquisition of control would in any other manner be in restraint of trade, and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;

(C) the financial condition of any acquiring person is such as might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank;

(D) the competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the interest of the depositors of the bank, or in the interest of the public to permit such person to control the bank;

(E) any acquiring person neglects, fails, or refuses to furnish the appropriate

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Federal banking agency all the information required by the appropriate Federal banking agency; or

(F) the appropriate Federal banking agency determines that the proposed transaction would result in adverse effect on the Bank Insurance Fund or the Savings Association Insurance Fund.

FN2 The Bank has represented that it will ensure that UCS's internal systems, third party data processing services, and purchased applications will be, by no later than December 31, 1998, Year 2000 compliant in accord with OCC issuances. In the event that UCS has a servicer or vendor which is not Year 2000 compliant, the Bank will ensure that the servicer or vendor, by December 31, 1998, has a Year 2000 compliance plan and the capacity to make its product or application Year 2000 compliant in accord with OCC issuances.

FN3 In addition, there is no corporate structural objection to the Bank holding a CEBA credit card bank and a Utah industrial loan company as subsidiaries. The OCC has previously approved the establishment of national credit card banks as operating subsidiaries. See OCC Conditional Approval No. 200 (April 12, 1996). See also OCC Conditional Approval No. 245 (May 13, 1997). Thus Georgia Bank may be an operating subsidiary of the Bank. The establishment of a Utah industrial loan company as a national bank subsidiary is similarly permissible. (In addition, the Bank has indicated that it will divest itself of the charter of Utah Bank within six months of consummation of the acquisition of CSC).

FN4 The Bank expects that the sole deposit at Georgia Bank will be a deposit of approximately $5 million from the Bank.

FN5 The location of the offices of Georgia Bank in Georgia and of Utah Bank in Utah, considered from the perspective of permissibility for the Bank, is consistent with the McFadden Act, 12 U.S.C. § 36. First, even if the offices and their activities were to be attributed to the Bank for McFadden Act purposes, they are permissible. The Bank has represented that the office of Georgia Bank will only take deposits from the Bank and not from customers who enter any premises. Its loan-making will be conducted only by credit cards. The offices of both Georgia Bank and Utah Bank do not serve customers in person and do not conduct business to attract customers from the general public in Georgia or Utah. A facility to which the public does not have access is not a branch for McFadden Act purposes, even if branch functions of 12 U.S.C. § 36(j) are performed there. See, e.g., OCC Interpretive Letter No. 634 (July 23, 1993), reprinted in [1993-1994 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 83,518; OCC Interpretive Letter No. 636 (July 23, 1993), reprinted in [1993-1994 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 83,520. Thus, assuming arguendo the offices were viewed as offices of the Bank, they are not branches and so do not violate the McFadden Act. Moreover, the offices are offices of a separate national bank and separate industrial loan company and conduct activities for those institutions, not for the Bank. Thus, arguably the offices should not be attributed to the Bank for branching purposes under the McFadden Act. See OCC Conditional Approval No. 200 (April 12, 1996).

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FN6 As subsidiaries of Citicorp, Georgia Bank and the Bank will be "depository institution affiliates" for the purposes of the Depository Institution Management Interlocks Act, 12 U.S.C. §§ 3201-3208, as implemented by 12 C.F.R. part 26. See 12 U.S.C. § 3201(3)(a) and 12 U.S.C. § 1841(d). Further, none of Georgia Bank's management officials holds a similar position in other depository institutions or depository holding companies for the purposes of the interlock prohibitions set forth in 12 U.S.C. §§ 3202, 3203.

FN7 The Financial Institutions Code of Georgia requires a company that wishes to acquire a bank, including a credit card bank, to make an application to the commissioner of the Department of Banking and Finance ("Department"). See Ga.Code Ann. § 7-1-606 (1997). Citicorp has applied for approval under this holding company provision.

Delaware law regulates entities that come within the definition of a "Delaware bank holding company" ("DBHC"). Del.Code Ann. tit. 5, § 851-857 (Michie Cum.Supp.1996). A DBHC is a company that is a bank holding company under 12 U.S.C. §§ 1841-1850, the operations of the bank subsidiaries of which are principally conducted in Delaware. As the Bank is not a bank holding company under the federal provision, these state provisions are inapplicable.

FN8 As to any other activities of Utah bank, the Bank has represented that Utah Bank engages in no activities that are not permissible for a national bank.

FN9 Presently, receivables are sold by Georgia Bank to CSC which in turn sells them to its subsidiary, Funding, a special purpose corporation. Funding transfers the receivables to a master trust that issues multiple series of securities from the same trust. The Bank has represented that it intends to merge Bancorp and Funding with and into CSC shortly following closing. Thenceforth, the securitization program will be effected by Georgia Bank's transfer of receivables directly into a master trust. As to receivables held by CSC following the merger of Funding, any low quality assets held by CSC and transferred to Georgia Bank will be contributed to, and not purchased by, Georgia Bank.

FN10 As to the application of 12 U.S.C. § 371c, to the extent that the Bank's subsidiary, CSC, is acting as a principal and is purchasing receivables it does not already own, its acquisition of receivables from Georgia Bank appears subject to the prohibition against the purchase of low quality assets by a bank and its subsidiaries and to the requirement that it be on terms and conditions that are consistent with safe and sound banking practices. See 12 U.S.C. § 371c(a)(3), (4). The other restrictions in 12 U.S.C. § 371c are not applicable as the so-called "sister bank" exemption applies to these transactions. See 12 U.S.C. § 371c(d)(1) and F.R.R.S. 3-1177.1. Since CSC purchases receivables from Georgia Bank on the same day that they are created, none of the assets purchased are "low quality assets" for the purposes of section 371c. See 12 U.S.C. § 371c(b)(10).

All transactions described in 12 U.S.C. § 371c-1 between the Bank and its affiliates and between Georgia Bank and its affiliates must comply with the comparative standard set forth in 12 U.S.C. § 371c-1(a)(1) or in the absence of comparable transactions with non-affiliated companies, with the good faith

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standard in 12 U.S.C. § 371c-1(a)(2).

FN11 The Bank will also indirectly acquire the 3.1 percent interest of Services in Mondex International. The Bank has committed that immediately after closing, the interest in Mondex International will be transferred to Citibank Overseas Investment Corporation ("COIC"), the Bank's Edge Act subsidiary, or a subsidiary of COIC. Consequently, the Bank will not hold its interest in Mondex International in an operating subsidiary.

FN12 In approving the Bank's request, the OCC approves only the same activities as approved in the Mondex Letter and based upon the same representations, agreements, and commitments. The Bank has confirmed that by filing the consolidated notice and applications, and accepting this approval, the Bank is deemed to have made the same representations, commitments and agreements as were made by the applicant banks in the initial Mondex notices.

FN13 This approval is subject to the following conditions: the Mondex LLCs may engage only in activities that are part of, or incidental to, the business of banking; the Bank will withdraw from the Mondex LLCs in the event one or both Mondex LLCs engages in an activity that is not part of, or incidental to, the business of banking; the Bank will account for the investment in the Mondex LLCs under the equity or cost method of accounting; and the Mondex LLCs will be subject to OCC supervision, regulation, and examination. These conditions are "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818.

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Office of the Comptroller of the Currency (O.C.C.)

Interpretive Letter

*1 CONCERNING THE PERMISSIBILITY OF THE BANK'S PROPOSAL TO SECURITIZE MOTOR VEHICLE RETAIL INSTALLMENT SALES CONTRACTS ("AUTO RECEIVABLES") PURCHASED FROM AUTOMOBILE DEALERS.
Interpretive Letter No. 585
June 8, 1992

This is in response to your letter of March 17, 1992, to Eric Thompson, Director of the Legal Advisory Services Division of the Office of the Comptroller of the Currency ("OCC"). On behalf of the above-captioned bank, you request the OCC's opinion concerning the permissibility of the Bank's proposal to securitize motor vehicle retail installment sales contracts ("auto receivables") purchased from automobile dealers.

As explained below, there is no legal objection to the Bank's proposal, which is similar to numerous other transactions that the OCC has approved for national banks. However, the Bank is advised that the transfer of the auto receivables under the proposed structure would not receive sales treatment for regulatory accounting purposes. The full amount of the receivables would remain on the Bank's balance sheet and the Bank would be required to hold regulatory capital against those assets.

The Proposal

According to your letter, and as more fully described in the Confidential Private Placement Memorandum and Pooling and Servicing Agreement that you provided, the transaction would be structured as follows. The Bank has a dealer-paper program under which selected automobile dealers originate auto receivables in accordance with the Bank's credit standards. The Bank purchases the receivables after performing its own independent credit review. The Bank proposes to transfer the receivables to an unaffiliated special purpose trust which would issue fixed rate certificates evidencing undivided fractional interests in the pool of receivables. The certificates would be divided into two classes, Class A and Class B.

The Class A certificates would represent 90% of the pooled assets and would be sold by an investment bank in private placements to institutional or otherwise accredited investors. The Class B certificates would represent 10% of the pooled assets and would be retained by the Bank. The rights of the Class B certificateholders to receive payments would be subordinate to the rights of the

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Class A certificateholders, in the event of defaults or delinquencies on the underlying auto receivables. The Class A certificateholders would also be protected by a "subordination spread account" of up to 5% of the outstanding pool balance, which would be funded by an initial 2% deposit from the Bank and, thereafter, from amounts otherwise distributable to the Class B certificateholders.

To the extent that defaults on the auto receivables exceed the amount of protection afforded by the Class B certificates and the subordination spread account, the Class A certificateholders would bear that risk of loss. The Class A certificateholders would not have recourse to the Bank, other than in its capacity as holder of the Class B certificates. The Bank would act as servicer for the pooled auto receivables pursuant to a subservicing agreement with the master servicer,

Analysis

*2 The Bank's proposal is similar to numerous proposals approved by the OCC in which national banks have used asset securitization as a means of selling or borrowing against their mortgage or other loan assets. See, e.g., Interpretive Letter No. 540 (December 12, 1990) reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,252 (credit card receivables); Interpretive Letter No. 418 (February 17, 1988) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,642 (mortgage assets); Interpretive Letter No. 417 (February 17, 1988) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,641 (mortgage assets); Interpretive Letter No. 416 (February 16, 1988) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,640 (leases and motor vehicle installment sales contracts); Interpretive Letter No. 388 (June 16, 1987) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (mortgage assets).

As explained in these interpretive letters, the use of asset securitization to accomplish the sale of a bank's loans or as a vehicle for borrowing against them is considered a permissible means by which a national bank may exercise its power to negotiate evidences of debt, or its authority to borrow money and pledge its assets as collateral. See 12 U.S.C. § 24 (Seventh) (granting national banks express power to discount and negotiate evidences of debt); Interpretive Letter No. 378 (March 24, 1987) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,602 (discussing national banks' authority to borrow money). Alternatively, the use of the securitization form to transfer bank loans has been considered a separate activity that is authorized as part of the business of banking under the incidental powers clause of 12 U.S.C. § 24 (Seventh). In Securities Industry Association v. Clarke, 885 F.2d 1034 (2nd Cir. 1989), cert. denied, 110 S. Ct. 1113 (1990), the United States Court of Appeals for the Second Circuit upheld the OCC's decision that a national bank's issuance and sale of mortgage-backed pass-through certificates was authorized under the national banking laws.

The Bank's proposal is within the above precedents and does not present any new

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legal issues. Because all of the activities proposed for the Bank are authorized as part of the business of banking, it is not necessary to consider whether the restrictions on certain bank securities activities that are contained in the Glass-Steagall Act would be applicable. See Securities Industry Association v. Clarke, 885 F.2d at 1050 (Glass-Steagall Act prohibitions do not apply to activities authorized as part of the business of banking). In addition, the fact that the Bank will not participate in any public distribution of the certificates, which will be privately placed by an investment banker, provides an independent basis for concluding that the Bank's activities would not be subject to the Glass-Steagall Act's prohibitions on securities underwriting and dealing. See Interpretive Letter No. 540, supra.

*3 One final point, which does not affect the legal permissibility of the transaction, concerns the Bank's proposed retention of the subordinate Class B certificates. From the information that you have provided, it appears that the Bank expects to account for the overall transaction as a sale of assets. The Bank is advised that if it retains the subordinate Class B certificates, it would be required to account for the transaction as a borrowing rather than a sale under applicable regulatory accounting principles.

Under the general rule for "sales of assets" provided in the Instructions for the Consolidated Reports of Condition and Income ("Call Report Instructions"), the transfer of a bank's loans is to be reported as a sale only if the transferring bank "retains no risk of loss from the assets transferred resulting from any cause ...." Call Report Instructions, Glossary -- Sales of Assets: General Rule. The Instructions specifically address transfers to special or limited purpose entities that are not technically affiliated with the seller (such as the trust in the Bank's proposal), stating that "regardless of the legal structure of the transaction, if the risk of loss is retained by the seller, either directly or indirectly, the transaction is to be reported as a borrowing by the seller even if the sale to the special purpose entity is stated as being without recourse."

In a senior/subordinate structure, such as the one proposed by the Bank, the subordinate class absorbs more than its proportionate amount of the total losses from the whole asset pool. In the event of defaults or delinquencies on the underlying assets, the rights of the subordinate class to receive its share of the payments are subordinate to the rights of the senior class. The subordinate class is a form of credit enhancement that is designed to protect the senior class from all or a portion of the credit risk associated with the transferred assets. Thus, *when a bank sells the senior class and retains the subordinate class, the bank* retains risk of loss from the transferred assets and is required to report the asset transfer as a borrowing. [FN1] In addition, the fact that the Bank in this case would provide the initial funding for the subordination spread account raises a separate question as to whether risk of loss would be retained from the transferred assets.

Accordingly, notwithstanding the Bank's description of the transfer as being "without recourse", under the proposed structure the Bank would be required to

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continue reporting the full amount of the auto receivables on its balance sheet. Regulatory capital would be required for the assets as though they had not been transferred. See 12 C.F.R. Part 3. See also 12 C.F.R. § 32.107(a) (sold loans may be removed from selling bank's lending limit only if the transfer results in a pro rata sharing of the credit risk).

I trust that this letter has been responsive to your inquiry.

*4 Sincerely,

Peter Liebesman

Assistant Director

Legal Advisory Services Division

FN1 One of the earliest OCC interpretive letters addressing the securitization of bank mortgage assets considered a national bank's use of a senior/subordinate structure. See Interpretive Letter No. 92 (April 20, 1979) reprinted in [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,167. In that letter, the OCC stated that the transaction would be treated as a sale of assets, notwithstanding the fact that the selling bank proposed to retain a subordinate class of pass-through certificates. The rules governing the regulatory reporting of bank asset transfers have since been revised and clarified, as described above, and the accounting treatment described in this interpretive letter is no longer applicable. See Federal Financial Institutions Examination Council, Request for Comment, 55 FR 26766, 26772 (June 29, 1990) (describing bank regulatory agencies' treatment of senior/subordinate structures as recourse arrangements when seller retains the subordinate class).

OCC Inter. Ltr. 585, Fed. Banking L. Rep. P 83,406, 1992 WL 598402 (O.C.C.)

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10 NO. 2 OCC Q.J. 56, OCC Inter. Ltr. 540, Fed. Banking L. Rep. P 83,252, 1991 WL 570780 (O.C.C.)

(Cite as: 1991 WL 570780 (O.C.C.))

Office of the Comptroller of the Currency (O.C.C.)

Interpretive Letter

*1 NATIONAL BANK OPERATING SUBSIDIARY TO FACILITATE SECURITIZATION OF BANK'S CREDIT CARD RECEIVABLES
Interpretive Letter No. 540
December 12, 1990

June 1991

LAWS:

12 U.S.C. 24(7)

REGULATIONS:

12 C.F.R. 5.34(c)

12 C.F.R. 7.7378

David C. Bouc, Senior Counsel Household International, Inc.

2700 Sanders Road

Prospect Heights, IL 60070

Dear Mr. Bouc:

This is in response to your letter on behalf of Household Bank, National Association, Salinas, California ("Bank"), notifying the Deputy Comptroller for the Western District of the Bank's intent to establish an operating subsidiary to be named Household Receivables Funding, Inc. ("Subsidiary"). The Subsidiary is being forme dto facilitate the securitization of credit card receivables held by the Bank in the ordinary course of its business.

The Proposal

According to the information provided in your letter and in subsequent telephone conversations with Laura Plaze, Senior Attorney in the Comptroller of the Currency's ("OCC") Legal Advisory Services Division, the Subsidiary will acquire credit card receivables that the Bank has originated or purchased from other

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credit card issuers in accordance with its usual credit standards. The Subsidiary will authorize, issue and deliver bonds or other evidences of indebtedness or certificated interests (in single or multi-class form), either directly or through trusts, which debt or certificated interests will be supported by the credit card receivables and by such third party credit enhancement as the Bank or the Subsidiary considers necessary. The Subsidiary will engage generally in such other activities as are incidental to accomplishing these activities.

The Bank has engaged an independent, unaffiliated investment banking firm to act as underwriter for the initial offering by the Subsidiary. The Bank, the Subsidiary and other Bank affiliates do not intend to engage in activities presently or in the future that would cause them to be treated as underwriters for purposes of the federal securities laws.

It is anticipated that the initial transactions to be engaged in by the Subsidiary will be structured as follows: The Subsidiary would purchase certain of the Bank's credit card receivables that are representative of its entire portfolio of credit card receivables. The receivables are, or will be, serviced by Household Credit Services, Inc. ("Servicer"), an affiliate of the Bank which currently services all of the Bank's receivables. The Subsidiary would sell or transfer the receivables to a trust created pursuant to a Pooling and Servicing Agreement between the Subsidiary, the Bank, the Servicer and an unaffiliated national bank acting as trustee. The Subsidiary would then cause the trust to issue and sell two classes of participation certificates ("certificates") to the independent underwriter, which would contemporaneously sell the certificates to investors in a public offering registered with the Securities and Exchange Commission under the Securities Act of 1933. The proceeds from the sale would fund the purchase of the receivables by the trust from the Subsidiary and by the Subsidiary from the Bank. The remainder of the purchase price for the receivables would be funded by a loan extended to the Subsidiary from the Bank's parent corporation, Household Finance Corporation.

*2 The holders of the certificates would not have any recourse against the Bank, the Subsidiary, the Servicer or any other affiliate thereof. Their only recourse would be to exercise their rights with respect to the underlying credit card receivables in the trust, or to enforce any credit enhancement vehicle that the Subsidiary or the trust might obtain from an unaffiliated bank to support the certificates. These facts would be brought prominently to the attention of prospective investors, who would also be specifically informed that the certificates do not represent deposits or obligations of the Bank and are not insured by the Federal Deposit Insurance Corporation.

In addition, the Bank represents that it will not finance any purchaser's acquisition of the certificates, will not purchase any of the certificates for the Bank's pension accounts or any trust or agency accounts as to which the Bank has investment discretion, will not promote the certificates, and will not lend money to the Subsidiary.

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10 NO. 2 OCC Q.J. 56, OCC Inter. Ltr. 540, Fed. Banking L. Rep. P 83,252, 1991 WL 570780 (O.C.C.)

(Cite as: 1991 WL 570780 (O.C.C.))

Discussion

A national bank may engage in activities which are part of or incidental to the business of banking through means of an operating subsidiary. See 12 C.F.R. § 5.34(c). The national banking laws grant national banks broad authority to buy and sell loan assets. See 12 U.S.C. § 24 (Seventh) (granting express power to discount and negotiate evidences of debt, and all such incidental powers as shall be necessary to carry on the business of banking). National banks also have broad authority to borrow money and to pledge their assets as collateral for such borrowings. See Interpretive Letter No. 378 (March 24, 1987), reprinted in [1988-1989 Transfer Binder] Fed.Banking L. Rep. (CCH) ¶ 85,602 (reviewing relevant case law).

On the basis of these authorizations, the OCC has approved numerous proposals in which national banks have used asset securitization as a means of selling or borrowing against their mortgage assets. See, e.g., Interpretive Letter No. 388 (June 16, 1987) reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612; Interpretive Letter No. 417 (February 17, 1988) reprinted in [1988-1989 Transfer Binder] Fed.Banking L. Rep. (CCH) ¶ 85,641; Interpretive Letter No. 418 (February 17, 1988) reprinted in [1988-1989 Transfer Binder] Fed.Banking L.Rep. (CCH) ¶ 85,642. In Securities Industry Association v. Clarke, 885 F.2d 1034 (2nd Cir.1989), cert. denied, 110 S.Ct. 1113 (1990), the United States Court of Appeals for the Second Circuit upheld the OCC's decision in Interpretive Letter No. 388 that a national bank's issuance and sale of pass-through certificates evidencing interests in a pool of its mortgage loans was authorized by the national banking laws. The Court held that the OCC had reasonably determined that the use of the certificate form to effect the sale of the bank's mortgage assets fell within the bank's incidental powers under 12 U.S.C. § 24 (Seventh).

The OCC has also approved the use of securitization as a means of selling other types of loan assets that a national bank has originated or acquired, specifically leases and motor vehicle installment sales contracts. See Interpretive Letter No. 416 (February 16, 1988), reprinted in [1988-1989 Transfer Binder] Fed.Banking L.Rep. (CCH) ¶ 85,640. The structure proposed for the Bank and the Subsidiary's credit card securitization program is very similar to the structure approved by the OCC in this Interpretive Letter. While the OCC has not previously addressed the legal authority for a national bank to sell or borrow against its credit card receivables through the use of securitization, it is clear that this activity is permitted for national banks.

*3 Credit card receivables are loan assets evidencing loans made on personal security. See 12 U.S.C. § 24 (Seventh) and 12 C.F.R. § 7.7378. National banks may purchase and sell these loan assets pursuant to their authority to discount and negotiate evidences of debt. Indeed, the United States Supreme Court has long recognized that the negotiation, i.e., the sale, of evidences of debt acquired through a national bank's express authority to lend money on the security of real

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estate is authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). See First National Bank of Hartford v. City of Hartford, 273 U.S. 548 (1927). Similarly, as the OCC stated in Interpretive Letter No. 416, the negotiation of loans made on personal security is also part of the business of banking. Accordingly, the Bank is authorized to sell its credit card receivables through use of the Subsidiary. In addition, because national banks are authorized to borrow money and to pledge their assets as collateral therefor, the Subsidiary is authorized to borrow funds in the market using the credit card receivables as collateral.

The use of securitization to accomplish the sale of the receivables or as a vehicle for borrowing against them is a permissible means by which a national bank may carry out these activities. As the OCC has previously noted, securitization is simply a means for effecting the selling, purchasing, borrowing and lending functions of the secondary market. See Interpretive Letter No. 418, supra. Through use of the various securitization structures, banks are able to sell and borrow against their assets in this market more efficiently. Just as when a bank securitizes its mortgage assets, the use of this form for the transfer of other loan assets can be viewed either as a new way for the bank to engage in established banking practices or as a separate activity that is authorized under the incidental powers clause of 12 U.S.C. § 24 (Seventh). See Securities Industry Association v. Clarke, supra; American Insurance Association v. Clarke, 865 F.2d 278 (D.C.Cir.1988) (essence rather than form determines whether an activity is part of the business of banking); M & M Leasing Corporation v. Seattle First National Bank, 563 F.2d 1377 (9th Cir.1977), cert. denied, 436 U.S. 956 (1978) (powers of national banks must be construed to permit new ways of conducting the very old business of banking).

Because the activities proposed for the Subsidiary are authorized as part of the business of banking, there is no need to consider the application of the restrictions contained in the Glass-Steagall Act on the extent to which a national bank may underwrite and deal in securities. See Securities Industry Association v. Clarke, 885 F.2d at 1050 (Glass-Steagall Act prohibitions do not apply to activities authorized as part of the "business of banking"). In addition, the fact that neither the Bank nor the Subsidiary will participate in the public distribution of the receivable-backed securities provides an independent basis for concluding that the proposed activities are not subject to the Glass-Steagall Act's prohibitions on securities underwriting.

***4** One final point concerns the Bank and its parent corporation's status under the Bank Holding Company Act of 1956 ("BHCA"). You indicated during an October 2, 1990 telephone conversation with Ms. Plaze that the Bank is a "credit card bank" that operates within the restrictions of Section 2(c)(2)(F) of the BHCA, as amended by the Competitive Equality Banking Act of 1987, 12 U.S.C. § 1841(c)(2)(F) . This section provides an exception from the definition of "bank" contained in the BHCA for institutions that engage only in credit card operations and meet certain other requirements. The parent corporations of such institutions are

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10 NO. 2 OCC Q.J. 56, OCC Inter. Ltr. 540, Fed. Banking L. Rep. P 83,252, 1991 WL 570780 (O.C.C.)

(Cite as: 1991 WL 570780 (O.C.C.))

generally not subject to the BHCA. As the Board of Governors of the Federal Reserve System is the primary federal regulator of bank holding companies, the Bank is advised to consult with the staff of that agency concerning whether the proposed securitization activities would be consistent with the exception for "credit card banks" provided in the BHCA.

In conclusion, because the national banking laws authorize the Bank to engage in the activities described in your notification letter, these activities may be performed in an operating subsidiary. The OCC does not object to the Bank's establishing the Subsidiary as proposed.

Sincerely,

J. Michael Shepherd

Senior Deputy Comptroller for Corporate and Economic Programs

END OF DOCUMENT

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8 NO. 1 OCC Q.J. 77, OCC Inter. Ltr. 452, Fed. Banking L. Rep. P 85,676, 1989 WL 451256 (O.C.C.)

(Cite as: 1989 WL 451256 (O.C.C.))

Office of the Comptroller of the Currency (O.C.C.)

Interpretive Letter

*1 Interpretive Letter No. 452
August 11, 1988

March 1989

LAWS:

12 USC 85

REGULATIONS:

12 CFR 7.7310

Linda Thomas Lowe, Esquire

Deputy Consumer Credit Code Administrator

Assistant Attorney General

Department of Justice

Hoover Building, 2d Floor

Des Moines, Iowa 50319

Re: Open-end Bank Credit Cards Issued by Citibank (South Dakota), N.A., and United Missouri Bank of Kansas City, N.A.

Dear Ms. Lowe:

This responds to your letter dated March 15, 1988, to Robert R. Klinzing, Deputy Comptroller for the Midwestern District of the Office of the Comptroller of the Currency (hereinafter, the "OCC"), and to your letter to me dated May 24, 1988. In your letter to Mr. Klinzing, you provide notice to the OCC of the determination of the Attorney General of the State of Iowa (hereinafter, the "Iowa Attorney General") that three fees and charges provided for in open-end credit card agreements entered into between Citibank (South Dakota), N.A. (hereinafter, "Citibank"), and Iowa residents violate Chapter 537 of the Iowa Consumer Credit

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Code (hereinafter, the "I.C.C.C."). Specifically, the three fees and charges to which your office expresses objections are Citibank's assessments of late fees, charges for nonsufficient funds ("N.S.F.") checks received by Citibank in payment on a consumer credit account, and cash advance fees, which your letter indicates might not be included in the finance charge or calculated in the A.P.R.

Similarly, in your letter to me, you advise the OCC of the Iowa Attorney General's determination that three fees and charges provided for in "private label" consumer credit cards issued to Iowans by United Missouri Bank of Kansas City, N.A. (hereinafter, "United Missouri"), also violate the I.C.C.C. Those three fees and charges are late fees, N.S.F. charges, and payment by the consumer of the attorneys fees incurred by United Missouri in any lawsuit it brings for collection of the account. For the reasons set forth below, it is my position that the laws of the states where the banks are located, South Dakota and Missouri, respectively, determine whether or not the banks can impose the foregoing fees and charges on Iowa residents.

I. The Banks' Credit Card Agreements With Iowa Residents are Governed by Federal Law and the Laws of the State Where Each Bank is Located.

The rate of interest that a national bank is permitted to charge on loans is governed by section 30 of the National Bank Act of 1864, codified in 12 U.S.C. § 85, and Interpretive Ruling 7.7310. Twelve U.S.C. § 85 authorizes a national bank to charge interest on any loan at:

the rate allowed by the laws of the State, ... where the bank is located ... except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. [FN1]

*2 12 U.S.C. § 85 (emphasis added).

The United States Supreme Court has interpreted the language cited as granting national banks "most favored lender" status, which means that a national bank may charge the highest interest rate allowed to other lenders by the laws of the state where it is located. See Tiffany v. National Bank of Missouri, 85 U.S. 409, 413 (1874); Marquette National Bank v. First of Omaha Service Corporation (hereinafter, "Marquette"), 439 U.S. 299, 314 n. 26 (1978). The "most favored lender" doctrine has been ratified consistently by the courts. See, e.g., First National Bank in Mena v. Nowlin, 509 F.2d 872 (8th Cir.1975); United Missouri Bank of Kansas City v. Danforth, 394 F.Supp. 774 (W.D.Mo.1975); Attorney General of Maryland v. The Equitable Trust Company, 294 Md. 385, 450 A.2d 1273 (1982). Similarly, the Supreme Court has found that section 85 incorporates state usury laws to determine the interest rate allowed by the state where the national bank is located. See Daggs v. Phoenix National Bank, 177 U.S. 549, 20 S.Ct. 732 (1900). These interpretations of section 85 are reflected in Interpretive Ruling 7.7310(a) as follows:

A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank

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making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate.
12 C.F.R. § 7.7310(a).

This Interpretive Ruling has never been questioned by any court and has been adopted by at least three courts as the basis for decisions involving the relationship between national banks and state usury laws. See United Missouri Bank of Kansas City, N.A. v. Danforth, supra; Attorney General of Maryland v. The Equitable Trust Company, supra; Northway Lanes v. Hackley Union National Bank & Trust Company, 464 F.2d 855 (6th Cir.1972). The permission given to national banks to charge interest at the rate allowed by the laws of the state where the bank is located is designed to place national banks on an equal footing with the most favored state-chartered lenders in that state, and to protect national banks from unfriendly state legislation. Marquette, 439 U.S. at 314; First National Bank of Mena v. Nowlin, 509 F.2d at 880; Commissioner of Small Loans v. First National Bank of Maryland, 268 Md. 305, 300 A.2d 685 (1973).

In Marquette, the Supreme Court held that, pursuant to 12 U.S.C. § 85, a national bank may charge interest on loans at the highest rate allowed by the law of the state "where the bank is located", even where the borrower resides in a different state. Marquette involved the issue of whether a national bank chartered in the state of Nebraska was authorized under section 85 to charge its Minnesota credit card customers an interest rate allowed by Nebraska law (18 percent annual rate on the first $999.99, and 12 percent on higher amounts) but exceeding the rate permitted by Minnesota law (12 percent fixed annual rate plus annual fee of up to $15.00). Based on the fact that the bank's charter address was in Nebraska and that the bank had no branches in Minnesota, the Court held that the bank was "located" in Nebraska for purposes of section 85 and so could export Nebraska's credit card rate to customers residing in Minnesota. The State of Minnesota, however, argued that the credit card program itself was located in Minnesota, and so the bank could not charge the Nebraska rate. In its resounding rejection of that argument, the Court reasoned that the bank "cannot be deprived of [its Nebraska] location merely because it is extending credit to residents of a foreign State." 439 U.S. at 310. The Court further reasoned that if a national bank's location were to depend on the location of each of its credit transactions:

*3 [T]he meaning of the term "located" would be so stretched as to throw into confusion the complex system of modern interstate banking. A national bank could never be certain whether its contacts with residents of foreign States were sufficient to alter its location for purposes of section 85. We do not choose to invite these difficulties by rendering so elastic the term "located."
Id. at 312.

The Court then rejected a suggestion by the State of Minnesota that section 85 somehow exempted interstate loans from its coverage. Based on its review of the legislative history of section 85, the Court concluded that Congress, when enacting section 85 in 1864, fully recognized the interstate nature of banking in

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the United States and drafted the statute to help facilitate a national banking system. Id. at 314-318. Based on the foregoing reasoning, the Court held that the bank was "located" in Nebraska for purposes of section 85. Accordingly, the bank was permitted to charge its customers the 18 percent interest rate permitted under Nebraska law, no matter where the customers resided.

The subjects of your two letters are credit card agreements entered into with Iowa residents by Citibank and United Missouri. The banks' charter addresses and places of business are in South Dakota and Missouri, respectively. In addition, neither bank has branches in Iowa. Thus, Marquette dictates a finding that Citibank is located in South Dakota and that United Missouri is located in Missouri for purposes of section 85. Therefore, the state laws which determine whether the fees and charges imposed by the banks in their credit card agreements are material to the determination of interest rate, and so can be exported to the banks' Iowa customers, are South Dakota law and Missouri law, respectively, not Iowa law.

II. The Laws of the States Where the Banks are Located Determine Whether the Fees and Charges Provided for in the Banks' Credit Card Agreements With Iowa Residents are Material to the Determination of Interest Rate

A national bank which, pursuant to 12 U.S.C. § 85, adopts the maximum permissible interest rate under the laws of the state in which it is located also is subject to those provisions of that state's laws which are "material to the determination of the interest rate." 12 C.F.R. § 7.7310(a). Interpretive Ruling 7.7310 has been cited with approval by a number of courts. See, e.g., Marquette, 439 U.S. at 314 n. 26; First National Bank in Mena v. Nowlin, supra; Fisher v. First National Bank of Omaha, 548 F.2d 255, 260 (8th Cir.1977); Fisher v. First National Bank of Chicago, 538 F.2d 1284, 1288 n. 9 (7th Cir.1976). Stated otherwise by the United States Court of Appeals for the Eighth Circuit in First National Bank in Mena:

The primary principle of construction of 12 U.S.C. § 85, to which Evans [FN2] might be considered a narrow exception, is that the federal Act adopts the entire case law of the state interpreting the state's limits on usury; it does not merely incorporate the numerical rate adopted by the state [citations omitted]. *4 509 F.2d at 876.

In my opinion, the foregoing principle applies whether the "provision of State law" that is "material to the determination of the interest rate" is a specific provision that sets restrictions on the rates and terms of loan transactions or allows for certain fees or charges, or instead, is legislative silence by the state. For example, in Daggs v. Phoenix National Bank, 177 U.S. 549, 20 S.Ct. 732 (1900), the Supreme Court held that an Arizona law which allowed lenders and borrowers to contract for any rate of interest also allowed national banks to charge any rate of interest. In Hiatt v. San Francisco National Bank, 361 F.2d 504 (9th Cir.1966), cert. denied, 385 U.S. 948 (1967), the U.S. Court of Appeals for the Ninth Circuit held that the silence of the California legislature regarding a maximum permissible interest rate had the same effect as did the

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Arizona law addressed in Daggs. Specifically, the Ninth Circuit stated:

No specific maximum rates were "fixed" by the Arizona statute, but in true effect, the law in both Arizona and California has "fixed" the rates for state banks in the two jurisdictions as without limitation except such as may be established by agreements between the banks of the two states and those who borrow from them.

361 F.2d at 507.

Thus, if a fee or other provision in a loan agreement is material to the determination of the interest rate, a national bank which adopts the maximum permissible interest rate under the law of the state in which it is located also is subject to that state's law pertaining to the fee or provision. As demonstrated above, this is so whether state law permits the provision by affirmative legislation or by the lack of legislation prohibiting it.

As stated above, whether the fees and charges provided for in a national bank's credit card agreements are provisions material to the determination of the interest rate depends on the law of the state where the bank is located. [FN3] However, set forth below is a discussion of case law addressing the issue of materiality.

In Northway Lanes v. Hackley Union National Bank & Trust Company, supra, the United States Court of Appeals for the Sixth Circuit concluded that when a national bank adopts the interest rate permitted by the law of the state in which it is located, it must also adopt that state's law pertaining to all fees and charges incurred in connection with making the loan. The issue before the Sixth Circuit was whether a national bank located in Michigan could impose certain add-on charges on real estate loans that state savings and loan associations, but not state banks, could impose. In concluding that national banks could impose such charges, the Sixth Circuit quoted with approval the following statement in the district court's opinion:

Since a savings and loan association can in fact charge 7% interest and in *addition thereto * * * require* a borrower to pay all reasonable and necessary charges incurred in connection with the making, closing and disbursing of real estate loans, it is the opinion of the court that a national banking association operating within the State of Michigan may do so also. To construe the Act otherwise would place a national bank in a competitively inferior position not contemplated by the federal statute.

*5 *464 F.2d at 864, quoting, 334 F.Supp. 723, 732 (W.D.Mich.1971).*

In Attorney General of Maryland v. The Equitable Trust Company, supra, the Court of Appeals of Maryland defined "material to the determination of the interest rate" for purposes of Interpretive Ruling 7.7310(a) as "material to a judicial determination of whether or not the interest charged in a given transaction is unlawful." 450 A.2d at 1292. The court found a broad range of credit card provisions in the Maryland Consumer Loan Law, including a five dollar N.S.F. fee and a restriction on additional fees, to be "material" inasmuch as they would

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8 NO. 1 OCC Q.J. 77, OCC Inter. Ltr. 452, Fed. Banking L. Rep. P 85,676, 1989 WL 451256 (O.C.C.)

(Cite as: 1989 WL 451256 (O.C.C.))

affect the amounts paid by the borrower on the loan.

The Supreme Court in Marquette also recognized the materiality of a national bank's annual credit card fees to the bank's determination of the interest rate it will charge on credit card loans. In Marquette, while Nebraska law permitted its lenders to charge a rate of 18 percent on credit card loans under $1,000.00 but prohibited such lenders from charging annual fees, Minnesota law "[t]o compensate for the reduced [12 percent] interest ... permits banks to charge annual fees of up to $15 for the privilege of using a bank credit card." 439 U.S. at 302-03.

Based on the holdings and reasoning in Northway Lanes and Marquette, the OCC has taken the position that state law providing for or prohibiting annual credit card fees is material to the determination of interest rate within the meaning of Interpretive Ruling 7.7310. See Staff Interpretive Letter by Richard V. Fitzgerald, Director, Legal Advisory Services Division, dated November 24, 1980. (A copy has been enclosed for your convenience). Referring to Marquette, the letter states that "often a state legislature, in creating interest rate *'packages,' will compensate for a low interest rate ceiling* by allowing a lender to charge specified fees." Staff Interpretive Letter at 4. Moreover, as the letter states, if a state law's prohibitions against annual credit card fees were to apply to out-of-state national banks:

> [A] national bank could be faced with the anomalous situation of being a "least favored lender," since it might be governed by the lower interest rate ceiling of the state where it is located but still not be permitted to levy the annual fees allowable under that state's laws. This anomalous situation could not have been intended by the authors of the National Bank Act.

Id. at 4.

Citing Northway Lanes, Mr. Fitzgerald opined in his letter that all charges permitted or prohibited by state law in connection with particular types of loans may be defined as "interest." Id. at 3.

III. Conclusion

Based on the foregoing reasoning, I conclude that whether it is permissible for Citibank (South Dakota), N.A., and United Missouri Bank of Kansas City, N.A., to charge their Iowa credit card customers the fees and charges described in your two letters depends on whether, under the laws of their respective home states, such fees and charges are material to the determination of the interest rates charged by those banks.

*6 I trust that this has been responsive to your inquiry.

Sincerely,

Robert B. Serino

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8 NO. 1 OCC Q.J. 77, OCC Inter. Ltr. 452, Fed. Banking L. Rep. P 85,676, 1989 WL 451256 (O.C.C.)

(Cite as: *1989 WL 451256* (O.C.C.))

Deputy Chief Counsel (Policy)

FN1 It should be noted that section 85 also permits national banks alternatively to charge an interest rate of one percent above the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the bank is located.

FN2 This refers to the Supreme Court's decision in Evans v. First National Bank of Savannah, 251 U.S. 108, 40 S.Ct. 58, 64 L.Ed. 171 (1919). In Evans, the Supreme Court held that a national bank in Georgia that had discounted short-term single payment notes and charged the maximum interest rate permissible under Georgia law, despite state prohibitions on discounting, had not violated section 85. The Supreme Court stated that under section 85 the bank needed to look to state law only to determine numerical rate, and could discount despite any state law prohibitions. The Eighth Circuit in First National Bank in Mena questioned the soundness of the Evans holding and confined it to its own facts of single payment, short-term commercial paper. 509 F.2d at 876. The Eighth Circuit based its decision not to extend the holding to installment credit in part on the fact that installment credit was virtually nonexistent at the time of Evans, id., and also in part on the emphasis that the Evans Court placed on the fact that discounting on single payment commercial paper was then widely practiced. Id. at 878.

FN3 In addition, regarding Citibank's credit cards, South Dakota law defines interest on credit card accounts and all other loan transactions as including, inter alia, charges for each return of a dishonored check, S.D.CODIFIED LAWS ANN. 51-24-12.1, charges for unanticipated late payments, S.D.CODIFIED LAWS ANN. 54-3-1 , "[o]ther charges made in connection with the revolving loan or charge account arrangement," S.D.CODIFIED LAWS ANN. 51-24-12.1, and "any other charges, direct or *indirect, as an incident to or as a condition of the extension of credit,"* S.D.CODIFIED LAWS ANN. 54-3-1. Thus, it would appear that under South Dakota law, the law of the state where Citibank is located, late fees, N.S.F. charges, and cash advance fees are part of, and so are material to, interest for the purposes of *Interpretive Ruling 7.7310(a).*

8 NO. 1 OCC Q.J. 77, OCC Inter. Ltr. 452, Fed. Banking L. Rep. P 85,676, 1989 WL 451256 (O.C.C.)

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1985 WL 151323 (O.C.C.)

Office of the Comptroller of the Currency (O.C.C.)

OCC Interpretive Letter

Banking Research Digest (c) BRG, Inc.

August 27, 1985

BRD SECTION:

Section 720A, File 16

LAWS:

12 U.S.C. § 24(7)

TOPICS:

General Powers:

Financial Processing

BRG DIGEST:

Letter states that a national bank may collect delinquent loans on behalf of other lenders and may provide billing services for doctors, hospitals, and other service providers.

This is in response to your request for a legal opinion confirming that your client, a national bank, may provide two services pursuant to the incidental powers clause of 12 U.S.C. § 24(Seventh). Under the first service, the bank would collect delinquent loans on behalf of other lenders. [FN1] The second service would consist of billing persons for fees owed to doctors, hospitals, and other service providers. As discussed below, it is my opinion that both of the services proposed here are permissible banking activities.

Under Interpretive Ruling 7.7379, 12 C.F.R. § 7.7379, the Office has taken the position that a national bank "may act as agent in warehousing and servicing of mortgages and other loans" as an incident to the business of banking pursuant to 12 U.S.C. § 24(Seventh). Similarly, the Supreme Court has established that section 24(Seventh) permits a national bank to "do those acts and occupy those relations which are usual or necessary in making collections of commercial paper and other evidences of debt" for its customers. Miller v. King, 223 U.S. 505, 510 (1912) (finding that a national bank may collect a judgement for its customer, and may also sue the bank's attorney in order to recover misused proceeds of the

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1985 WL 151323 (O.C.C.)

judgement). Thus, the debt "servicing" activities permitted by section 24 (Seventh) encompass those functions that are "usual or necessary" in making collections of debt.

In applying the preceding principles, the Office has traditionally looked to the usual and necessary functions banks undertake in collecting their own loans as a guide to the Office's determination of whether a particular activity is a permissible means of "servicing" debts owed to others. In particular, the Office has found that a bank may service loans in an agency capacity by engaging in collection activities with respect to delinquent loans on behalf of other lenders. See Interpretive Letter of July 27, 1978, reprinted in Fed. Banking Law Rep. (CCH) ¶ 85,128. Reaffirming that Office opinion, I note that it is both usual and necessary for banks to undertake collection activities with respect to their own delinquent loans. Thus, it is permissible for national banks to collect delinquent loans on others' behalf, as in the first service you described, pursuant to section 24(Seventh). In addition, the Office has recognized that banks may provide billing services to collect amounts due in repayment of money lent and in payment of other forms of receivables. Since billing activities form an integral part of the means by which debts are collected by banks, it is therefore my view that banks may provide billing services to collect amounts due to others. Consequently, it is my opinion that the billing service you described falls within the scope of the incidental powers clause of section 24(Seventh).

Finally, your letter noted that the bank in question might wish to provide the collection and billing services discussed above through an operating subsidiary. Operating subsidiaries of national banks may perform activities that are a part of or incidental to the business of banking. See 12 C.F.R. § 5.34(c). Since the services you described are permissible banking activities, the bank could provide the services by means of an operating subsidiary provided, of course, that the bank complies with the notification and other requirements of 12 C.F.R. § 5.34.

I trust that this has been responsive to your inquiry.

Sincerely,

Peter Liebesman

Assistant Director

Legal Advisory Services Division

FN1 You noted that the bank would comply with the Fair Debt Collection Practices Act, 15 U.S.C. § 1692 et seq., and any other applicable provisions of law.

1985 WL 151323 (O.C.C.)

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DOCKETED

IDAHO COUNTY DISTRICT COURT
FILED
AT 5:00 O'CLOCK P.M.

JUL 17 2007

ROSE E. GEHRING
CLERK OF DISTRICT COURT
DEPUTY

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Attorneys for Citibank (South Dakota) N.A.

IN THE DISTRICT COURT OF THE SECOND JUDICIAL DISTRICT

OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF IDAHO

CITIBANK (SOUTH DAKOTA) N.A., Plaintiff/Counterdefendant, vs. MIRIAM G. CARROLL, Defendant/Counterclaimant.	Case No. CV-2006-37067 AFFIDAVIT OF MICHAEL LARSEN

STATE OF IDAHO)
)
County of Ada)

MICHAEL LARSEN, being first duly sworn upon oath, deposes and states as follows:

1. I am Bureau Chief of the Consumer Finance Bureau of the Idaho Department of Finance. The Idaho Department of Finance administers and enforces the Idaho Collection Agency Act ("ICAA"), Idaho Code § 26-2221, *et seq.* The Department of Finance is the state

agency to which applications for collection agency permits must be made. Idaho Code § 26-2223. The Department of Finance determines whether or not an applicant meets the qualifications of the ICAA. Idaho Code § 26-2229.

2. I have been contacted by a Boise attorney who stated that he is counsel for Citibank (South Dakota) N.A. ("CITIBANK"). The attorney represented to me that a question has arisen in the above-captioned action as to whether CITIBANK is required to be licensed under the ICAA, Idaho Code § 26-2221 *et seq.*, to engage in collection activities in Idaho.

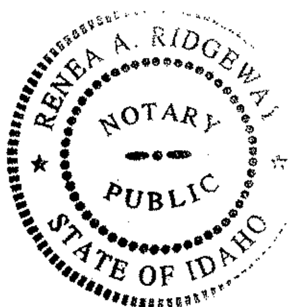
3. I am aware that CITIBANK is a national bank, and its regulator is the Office of the Comptroller of the Currency ("OCC").

4. The Department of Finance does not license national banks under the ICAA whether they are collecting their own debts or the debts of third parties because national banks are regulated lenders as defined at Idaho Code § 28-41-301(37) and are therefore exempt from the application of the ICAA, pursuant to I.C. § 26-2239(2).

DATED this 12th day of July, 2007.

MICHAEL LARSEN

SUBSCRIBED AND SWORN before me this 12 day of July, 2007.



Name: Renea A. Ridgeway
Notary Public for Idaho
Residing at Boise, Idaho
My commission expires 11-20-09

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 16th day of July, 2007, I caused to be served a true copy of the foregoing AFFIDAVIT OF MICHAEL LARSEN by the method indicated below, and addressed to the following:

Miriam G. Carroll
HC-11 Box 366
Kamiah, ID 83536
[*pro se*]

✓ U.S. Mail, Postage Prepaid
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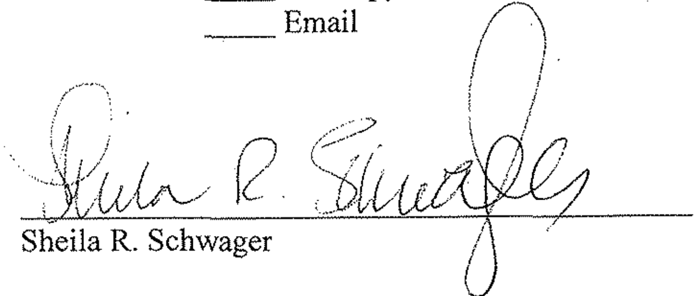

Sheila R. Schwager

IDAHO COUNTY DISTRICT COURT
FILED
AT 11:07 O'CLOCK A .M.

JUL 09 2007

ROSE E. GEHRING
CLERK OF DISTRICT COURT
[signature] DEPUTY

DOCKETED

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Attorneys For Citibank (South Dakota), N.A.

IN THE DISTRICT COURT OF THE SECOND JUDICIAL DISTRICT OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF IDAHO

CITIBANK (SOUTH DAKOTA), N.A., Plaintiff/Counterdefendant, vs. MIRIAM G. CARROLL, Defendant/Counterclaimant.	Case No. CV-2006-37067 PLAINTIFF'S REPLY AND OPPOSITION TO DEFENDANT'S MOTION FOR SHOW CAUSE HEARING

Plaintiff, Citibank (South Dakota), N.A. ("CITIBANK"), by and through its attorneys of record, Hawley Troxell Ennis & Hawley LLP, hereby submits this brief in reply and in opposition to the Defendant's Motion For Show Cause Hearing. The Defendant's Motion contends that (despite the Order by this Court holding otherwise), CITIBANK was required to submit documentation regarding ownership of the receivables. The Defendant's Motion should be denied in its entirety.

I. INTRODUCTION

On January 19, 2007, CITIBANK filed a Motion For Summary Judgment to resolve this case. The hearing on the motion was set for February 22, 2007. In response, Defendant filed numerous motions requesting various continuances. The scheduled hearing date was continued at the Defendant's request to March 29, 2007. CITIBANK then filed a Motion to Vacate the Trial, which was also set for hearing on March 29, 2007. At the hearing on March 29, 2007, the Defendant raised the issue of standing and this Court made inquires as to the securitization process used by CITIBANK and the relationship between CITIBANK and the Trusts that are a part of that process. Particularly, this Court raised inquiries as to how the relationship between CITIBANK and the Master Trust affected the Idaho Collections Agency Act ("ICAA").

At the conclusion of the hearing, this Court ruled the trial date was vacated, the summary judgment hearing date was continued, and a limited discovery order was set forth for documentation demonstrating the relationship between CITIBANK and the Master Trust by May 29, 2007. A briefing schedule was also set forth for the parties to address the standing/ICAA issues. At the conclusion of the hearing, the Defendant's representative, Mr. Capps, asked this Court whether CITIBANK could also be ordered to provide additional documentation regarding the debt, i.e. whether it was currently held by the Master Trust or CITIBANK, based upon discovery requests the Defendant had propounded upon CITIBANK. This Court declined that request stating that the outcome of the pending briefing may resolve the issues, and after the matter was ruled upon this Court would determine whether additional discovery would be allowed.

As a result, on April 5, 2007, this Court entered an Order Vacating Trial Date; Continuing Summary Judgment Hearing and Granting Limited Discovery ("Order"), which provided, in pertinent part:

> IT IS HEREBY FURTHER ORDERED, ADJUDGED AND DECREED the Summary Judgment hearing is continued to be set at a later date by the Court, **after limited discovery** and further briefing is provided **as set forth herein**;
>
> IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that **Citibank shall provide documentation to the Defendant, setting forth the relationship between Plaintiff and the Master Trust**, no later than May 29, 2007;
>
> THAT Citibank shall submit supplemental briefing addressing the Idaho Collection Agencies Act **and the relationship between Plaintiff and the Master Trust** no later than May 29, 2007;
>
> THAT the Defendant shall submit an opposition brief, if any, to Citibank's supplemental briefing no later than June 29, 2007;
>
> THAT Citibank shall submit a reply brief no later than July 13, 2007. At that time the Court will take the matter under advisement and set a hearing date for the pending Motion for Summary Judgment.

See Exhibit A attached hereto (emphasis supplied).

This Court's Order is very clear and unambiguous as to what was to be produced and submitted by CITIBANK and CITIBANK has complied with that Order. On May 25, 2007, CITIBANK federal expressed its supplemental brief for filing and for delivery to the Defendant. In addition, CITIBANK filed and served upon the Defendant 327 pages of documentation setting forth the securitization process and relationship between CITIBANK, the Master Trust, and the Issuance Trust, in accordance with this Court's Order. In the briefing and documents

CITIBANK's counsel attempted to set forth as concisely as possible with itemized, highlighted, and indexed support for each statement, the relationship and securitization process.

Prior to June 21, 2007, the Defendant never raised an issue as to this Court's signed order on April 5, 2007. Still to date, the Defendant does not address the written order. Instead, the Defendant ignores the signed order and contends that this Court made orders that are contrary to that written order and goes further to actually argue that CITIBANK should be held in contempt, despite the complete and full compliance with this Court's April 5, 2007 Order. Defendant's motion is without merit.

II. CITIBANK HAS FULLY COMPLIED WITH THE COURT'S ORDER FOR LIMITED DISCOVERY "SETTING FORTH THE RELATIONSHIP BETWEEN THE PLAINTIFF AND THE MASTER TRUST."

The Court's April 5th Order required CITIBANK to (1) "provide documentation to the Defendant, setting forth the relationship between Plaintiff and the Master Trust" and (2) "submit supplemental briefing addressing the Idaho Collection Agencies Act and the relationship between Plaintiff and the Master Trust." In response to the Order, CITIBANK prepared a brief that explains the securitization process, including the purpose and roles of the Citibank Credit Card Master Trust I (the "Master Trust") and the Citibank Credit Card Issuance Trust (the "Issuance Trust"). Attached to the brief are six exhibits:

- Prospectus Issued by Citibank Credit Card Issuance Trust, Dated February 5, 2007
- Prospectus Supplement Issued by Citibank Credit Card Issuance Trust, Dated March 14, 2007
- Comptroller of the Currency, Corporate Decision #20006-08, Dated September 2006
- *Citibank Credit Card Issuance Trust- Trust Agreement*, Dated September 12, 2000

- *Citibank Credit Card Master Trust I, Pooling and Service Agreement*, Dated May 29, 1991
- *Citibank Credit Card Issuance Trust/Credit Card Master Trust I*, Monthly Form

Those documents explain and confirm CITIBANK's affiliation, control and beneficial relationship with the Master Trust and the Issuance Trust. As explained in the supplemental brief, in a nutshell, CITIBANK transfers an interest in credit card receivables to the Master Trust. The Master Trust issues a Collateral Certificate to the Issuance Trust, which is an investor certificate representing an undivided ownership interest in the receivables. The Issuance Trust then issues notes to third party investors, which are secured by the Collateral Certificate. As a result, these third party investors at no time have an ownership interest in the Master Trust, the receivables held by the Master Trust, or the Issuance Trust. Instead, the third party investors simply have a note, wherein money is owed to them by the Issuance Trust, ultimately secured by the Collateral Certificate.

The sole beneficiary and ultimate controller of the Issuance Trust is CITIBANK. The Master Trust works for the benefit of the certificate holders, which is primarily the Issuance Trust. CITIBANK is the sole beneficiary and manager of the Issuance Trust, and is therefore the primary beneficiary of the Master Trust.

Not only is CITIBANK the primary beneficiary of the Master Trust, thereby indirectly controlling the Master Trust, CITIBANK also has direct control of the Master Trust. CITIBANK is responsible for servicing, managing, and making collections on the credit card receivables in the Master Trust; making determinations with respect to the Master Trust; and allocating funds received by the Master Trust. Thus, the securitization process both starts and ends with CITIBANK maintaining ultimate control through its affiliated trust entities.

Every statement set forth in the Supplemental Brief is painstakenly cited to the tabbed and highlighted documentation provided to the Defendant. Thus, CITIBANK has fully complied with this Court's order that Defendant be provided with documentation "setting forth the relationship between Plaintiff and the Master Trust."

III. THE DISCOVERY PERIOD HAS EXPIRED IN THIS CASE AND THERE IS NO PENDING MOTION TO REOPEN DISCOVERY

Pursuant to the Scheduling Order entered by this Court on September 15, 2006, all discovery in this case was to be completed by March 15, 2007. At the hearing on March 29, 2007, the Defendant requested additional discovery regarding the account and this Court held that any other discovery issues, other than documentation setting forth the relationship between the Master Trust and CITIBANK, would be decided after a hearing and ruling was made on the pending summary judgment motion and standing briefing.

In compliance with this Court's Order, CITIBANK filed a Supplemental Brief in Support of the Motion for Summary Judgment, the Defendant filed an opposition brief and CITIBANK is in the process of drafting the reply brief. As stated by this Court at the prior hearing, once the oral argument takes place as to that briefing and a ruling is made by this Court, then the Court can address discovery issues, if necessary.[1]

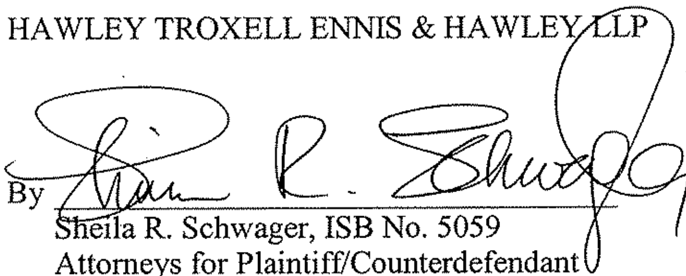
[1] Although the Defendant conclusory states that the ownership of the Receivables is relevant and material to the standing issue, she merely makes legal arguments that are the subject of the standing/ICAA briefing before this Court. CITIBANK has set forth in the Supplemental Brief and will further set forth in the Reply Brief that <u>even if</u> the Master Trust currently owned the Receivables (which it does not) that CITIBANK has standing and is not subject to the ICAA, pursuant to I.C. § 26-2239(10) and/or § 26-2239(2). Thus, the factual question of whether the Master Trust owns the Receivables is not necessary to determine the standing/ICAA issue.

IV. CONCLUSION

In this case, through the extensive discovery propounded by both parties, it has been established beyond refute that the Defendant incurred debt from her admitted use of the credit card issued by CITIBANK and that the Defendant failed to pay for that debt. The Supplemental Brief, Reply Brief, and produced documents will establish that CITIBANK unquestionably has standing in this case and is not subject to the ICAA. For the reasons stated above, Defendant's Motion For Show Cause Hearing should be Denied.

DATED THIS 5th day of July 2007.

HAWLEY TROXELL ENNIS & HAWLEY LLP



By

Sheila R. Schwager, ISB No. 5059
Attorneys for Plaintiff/Counterdefendant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 5th day of July, 2007, I caused to be served a true copy of the foregoing PLAINTIFF'S REPLY AND OPPOSITION TO DEFENDANT'S MOTION FOR SHOW CAUSE HEARING by the method indicated below, and addressed to each of the following:

Ms. Miriam G. Carroll
HC-11 Box 366
Kamiah, Idaho 83536
[pro se]

_X__ U.S. Mail, Postage Prepaid
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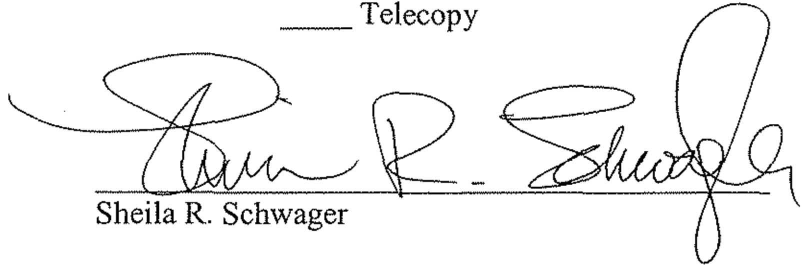

Sheila R. Schwager