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BANKING CRISIS ALERT

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The Bank May Fail. What Should I Do About Its Letter of Credit?

The recent spate of bank failures and mergers raises many issues not addressed since the savings and loan crisis of the 1980's and 1990's. One issue is the effect of a bank's failure and its subsequent receivership or merger on its outstanding standby letters of credit ("LOC"). Is an acquiring bank or the FDIC required to pay the full amount of the LOC or is the beneficiary simply out of luck?

If a bank fails, the FDIC can enter into a purchase and assumption agreement with an acquiring bank. If the LOC is assumed by the acquiring bank, the beneficiary is in great shape. Unfortunately for the beneficiary, the acquiring bank is not obligated to assume the LOC. If the LOC is not assumed, the beneficiary is out of luck. The FDIC's position is that it is not required to honor standby letters of credit.

Accordingly, a beneficiary of an LOC issued by a troubled institution should carefully review its documents with its counter-party. There may be defaults under the loan documents or the financial instability of the issuing bank may provide the beneficiary with grounds to immediately draw on the LOC, or request additional collateral, guarantees or other credit enhancements to either prevent or lessen the loss should the issuing bank be placed in FDIC receivership and the LOC repudiated.

Please contact **Andy Gold** at (212) 592-1459 or agold@herrick.com if you have any questions regarding this alert.

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