CHAPTER 1

BANKS AND SAVINGS ASSOCIATIONS

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. No. 111-203) (the “DFA”), mandates significant changes to the regulation of banks, savings associations, and their holding companies. The DFA provisions include a hodgepodge of (i) regulatory relief, (ii) deposit insurance reform, (iii) safety and soundness restrictions, (iv) merger and acquisition restrictions, (v) activity and transaction restrictions, and (vi) provisions relating to the abolition of the Office of Thrift Supervision (OTS) as the regulator of savings associations and savings and loan holding companies. The focus of this chapter is to discuss the changes that the DFA mandates, the new rules that have been issued by the regulators, and how best to implement them.

I. REGULATORY RELIEF

While the DFA provides for one of the broadest expansions of regulatory restrictions on financial institutions in the past two decades, the DFA also provides some regulatory relief by permitting banks and savings associations to (i) offer interest bearing demand deposit accounts and (ii) engage in de novo interstate branching.

A. Interest on Demand Deposit Accounts Authorized

Effective July 21, 2011, DFA § 627 repealed the federal banking law prohibitions on paying interest on “demand deposit” accounts.¹ A “demand

¹The statutory prohibitions that were repealed were set forth in 12 U.S.C. §§ 371a, 1464(b)(1)(B), and 1828(g) and Regulation Q (12 C.F.R. pt. 217). The Federal Reserve Board repeal of Regulation Q (which implemented the prohibition on interest on demand deposits) was set forth in 76 Fed. Reg. 42015 (July 18, 2011).
“deposit” generally means a deposit that is payable on demand or on less
than seven days’ prior notice.²

Prior to the DFA’s repeal of demand account interest restrictions,
insured depository institutions could only offer two types of interest-
bearing checking accounts: (1) negotiable order of withdrawal accounts
(which were limited to individuals, sole proprietorships, government-
tal units, and nonprofit organizations) and (2) automatic transfer service
accounts (which were limited to individuals and sole proprietorships). In
order to offer either of these accounts, the bank had to reserve the right
to require a minimum seven-day prior notice of withdrawal from the
customer.

With the lifting of this prohibition, banks will now be able to offer
interest-bearing checking accounts to business customers. Businesses
will no longer be limited to receiving interest through “sweep” services,
where funds are temporarily moved from a business checking account to
a separate investment account on an overnight basis.

B. De Novo Interstate Branching Permitted for Banks

DFA § 613 preempts state laws to permit de novo interstate branching
by national banks and state chartered banks in all fifty states.³ An out-
of-state bank is now permitted to establish one or more branches in
another state to the same extent as is a state bank chartered by such
state, without having to (i) purchase a bank or branch (if permitted by
state law) with a minimum age of up to five years or (ii) purchase a shell
bank charter in that state pursuant to a “strip” sale of the bank, where
the assets are sold to one bank and the charter is sold to another bank
(if such a transaction is permitted by the appropriate banking agency).⁴
This change will be particularly helpful to small community banks that
want to branch into another state but do not have the resources to pur-
chase a bank in another state to effect the transaction.

It should be noted that interstate de novo branching is not a new
development. The Riegle-Neal Interstate Banking and Branching
Efficiency Act of 1994 (Pub. L. No. 103-328) permitted each state to
individually enact legislation to permit interstate de novo branching. At

2. See 12 C.F.R. § 204.2(b)(1).
3. DFA § 613, revised 12 U.S.C. §§ 36(g)(1)(A) (national banks) and 1828(d)(4)(A)(i)
(state-chartered banks).
the time of the enactment of the DFA, most states had already enacted “opt-in” legislation to permit de novo branching. Furthermore, the OTS has permitted federal savings associations to conduct de novo interstate branching since 1993.\textsuperscript{5}

\section*{II. Deposit Insurance Reform}

The DFA significantly reformed the structure of Federal Deposit Insurance by (i) increasing the amount of deposit insurance for certain insured deposit accounts and (ii) revising the formula for the calculation of the deposit insurance premium of the Deposit Insurance Fund (DIF).

\subsection*{A. Increase in Deposit Insurance Amounts}

DFA § 335 permanently increased the standard maximum deposit insurance amount for all insured depository institutions (including credit unions) from $100,000 to $250,000.\textsuperscript{6} The increase was made retroactive to January 1, 2008, which permitted depositors that suffered from a bank receivership between January 1, 2008, and October 3, 2008, to be insured for up to $250,000 per account. In August 2010, the Federal Deposit Insurance Corporation (FDIC) amended its regulations to require that no later than January 3, 2011, banks and savings associations were to put signs in their lobbies stating: “Each depositor insured to at least $250,000.”\textsuperscript{7}

DFA § 343 temporarily provided unlimited deposit insurance through December 31, 2012, for noninterest-bearing transaction accounts, such as demand deposit checking accounts. On December 29, 2010, Congress temporarily provided unlimited deposit insurance to Interest on Lawyer Trust Accounts through December 31, 2012.\textsuperscript{8}

These changes resulted in, as of December 31, 2011, all insured depository institutions having to separately report the amount and number of noninterest-bearing transaction accounts exceeding $250,000 in their quarterly reports of financial condition.

\textsuperscript{5} 12 U.S.C. § 1464(a)(1) (statutory authority for preemption of state laws); 12 C.F.R. § 545.92 (interstate branching regulation).

\textsuperscript{6} DFA § 335 is codified in 12 U.S.C. §§ 1821(a)(1)(E), 1787(k)(5).

\textsuperscript{7} 75 Fed. Reg. 49363 (Aug. 13, 2010) (amending 12 C.F.R. §§ 330.1(n) (standard deposit insurance amount) and 328.1(a) (signage)).

B. Changes to Deposit Insurance Assessment Structure

Banks and savings associations are required to insure their customer accounts with FDIC deposit insurance and pay quarterly assessments (i.e., insurance premiums) to the Deposit Insurance Fund (DIF). Section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. § 1817(b)) requires that the FDIC, by regulation, establish a risk-based assessment system for insured depository institutions. The FDIC’s assessment base regulations are set forth in 12 C.F.R. pt. 327.

The DFA amended the Federal Deposit Insurance Act in response to criticism by some that (i) the minimum designated reserve ratio for the DIF was too low to provide adequate funding for future losses to the DIF and that (ii) large and complex banks with assets of $10 billion or more were not paying a large enough share of the deposit insurance assessments.9

**Designated Reserve Ratio Increased.** DFA §§ 332 and 334 increased the amount of funds that will be available for future losses to the DIF by (i) increasing the minimum designated reserve ratio (DRR) from 1.15 percent to 1.35 percent; (ii) requiring that the FDIC structure the assessments so that the DIF can have a minimum DRR of 1.35 percent no later than September 30, 2020 (replacing the former requirement that the DRR be increased to 1.15 percent by December 31, 2016); (iii) removing the 1.5 percent cap on the DIF’s reserve ratio; and (iv) terminating the requirement that the FDIC provide dividends from the DIF to insured depository institutions when the reserve ratio is between 1.35 percent and 1.50 percent.10 DFA § 334(e) requires that the FDIC “offset the effect” of the required increase in the designated reserve ratio to 1.35 percent “on insured depository institutions with total consolidated assets of less than $10,000,000.”

**Change In DIF Assessment Base Formula.** DFA § 331(b)(2)(A) requires that the FDIC amend its regulations with respect to assessments to define the term “assessment base” to mean (i) “the average consolidated total assets of the insured depository institution during the assessment period” minus (ii) the sum of the average tangible equity of the insured depository institution during the assessment period.” This is a significant change, because the base assessment formula had been previously based upon the amount of the bank’s deposits, rather than

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9. DFA § 331; see also the FDIC’s subsequent revisions to 12 C.F.R. pt. 327, which are described in FDIC FIL-8-2011, Assessments Final Rule (Feb. 9, 2011).
10. 12 U.S.C. §§ 1817(e) (suspension of dividends by FDIC) and 1817(b)(3)(B) (minimum reserve ratio).
its assets. This formula change was made as part of a legislative effort to increase the share of deposit insurance assessments paid by large and complex banks, which tend to be less reliant on deposits.

For “bankers banks” and “custodial banks,” DFA § 331(b)(2)(B) requires that the FDIC amend its regulations with respect to assessments to define the term “assessment base” to mean (i) “the average consolidated total assets of the insured depository institution during the assessment period” minus (ii) the sum of a formula amount to be determined by the FDIC. A “bankers bank” is a bank that is “engaged exclusively as in providing service to or from other depository institutions, their holding companies, and the officers, directors, and employees of such institution and companies, and in providing correspondent banking services at the request of other depository institutions or their holding companies.”¹¹ A “custodial bank” is an insured depository institution with previous calendar year-end trust assets (that is, fiduciary and custody and safekeeping assets, as reported on Schedule RC–T of the bank’s Call Report) of at least $50 billion or an insured depository institution that derived more than 50 percent of its revenue (interest income plus non-interest income) from trust activity over the previous calendar year.¹²

On February 25, 2011, the FDIC published its final regulations that amended 12 C.F.R. pt. 327 to implement the required changes to the DIF assessment base calculation. The regulations took effect for the quarter beginning April 1, 2011, and were reflected in invoices for quarterly assessments due on September 30, 2011.¹³

The FDIC’s definitions of “average consolidated total assets” and “average tangible equity” are set forth in 12 C.F.R. § 327.5. These terms are defined as follows:

• **Average Consolidated Total Assets.** For depository institutions with assets of $1 billion or more, “average consolidated total assets” is the sum of the gross amounts of consolidated total assets as of the close of business on each calendar day during the calendar quarter divided by the number of calendar days in the calendar quarter. For depository institutions with assets of less than $1 billion, “average consolidated total assets” can be calculated using either (i) the sum

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¹². 12 C.F.R. § 327.5(c)(1).
¹³. 12 C.F.R. § 327.5(a)(2).
of the gross amounts of consolidated total assets as of the close of business on each Wednesday during the calendar quarter or (ii) the daily calculation method (after permanently opting in to using this calculation method).

- **Average Tangible Equity.** For depository institutions with assets of $1 billion or more, “average tangible equity” is the average of three month-end balances of Tier 1 capital. For depository institutions with assets of less than $1 billion, “average tangible equity” can be calculated using either (i) an end-of-calendar quarter balance calculation or (ii) the monthly average balance calculation (after permanently opting in to using this calculation method).

In determining the assessment rate for large and highly complex institutions, the FDIC created an adjustment to the total score “up or down, by a maximum of 15 points, based upon significant risk factors that are not adequately captured in the appropriate scorecard.”

A “large institution” is (i) an insured depository institution with assets of $10 billion or more as of December 31, 2006, (ii) an insured depository institution with assets of $10 billion or more in its quarterly reports of condition for four consecutive quarters, or (iii) an insured depository institution with between $5 billion and $10 billion in assets that requests and is approved by the FDIC, to be treated as a large institution.

A “highly complex institution” is a an insured depository institution that (i) has had $50 billion or more in total assets for at least four consecutive quarters and that is controlled by a U.S. parent holding company that has had $500 billion or more in total assets for four consecutive quarters, (ii) is controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters, or (iii) is a processing bank or trust company that has $10 billion in total assets and $500 billion or more in total fiduciary assets.

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15. 12 C.F.R. § 327.5(a)(ii). The FDIC has additionally defined the assessment base calculations for the following types of entities: (i) bankers banks (12 C.F.R. § 327.5(b) (3)), (ii) custodial banks (12 C.F.R. § 327.5(c)(2)), and (iii) insured branches of foreign banks (12 C.F.R. § 327.5(d)).
16. 12 C.F.R. § 327.9(b)(3).
17. 12 C.F.R. §§ 327.8(f), 327.9(e).
18. 12 C.F.R. §§ 327.8(g), 327.8(e).
III. SAFETY AND SOUNDNESS RESTRICTIONS

A. Countercyclical Capital Requirements for Insured Depository Institutions and Their Holding Companies

DFA § 616 requires that federal banking agencies make capital requirements for insured depository institutions and their holding companies “countercyclical, so that the amount of capital required to be maintained . . . increases in times of economic expansion and decreases in times of economic contraction.”

Currently, an insured depository institution must be “well capitalized” to not be subject to certain restrictions on their activities. Federal regulations require that, in order to be well capitalized, an insured depository institution must have at least a 5 percent leverage capital ratio, a 6 percent Tier 1 risk-based capital ratio, and a 10 percent total risk-based capital ratio. Furthermore, since 2008, federal banking agencies have issued a large number of consent orders and cease and desist orders against banks and savings associations that effectively condition the “well capitalized” classification on the maintenance of an 8 percent leverage capital ratio and a 12 percent total risk-based capital ratio.

To date, federal banking agencies have not promulgated any regulations with respect to DFA § 616. However, on December 16, 2010, the Basel Committee on Banking Supervision (which is a committee of bank regulators from 27 nations, including the United States), published revised capital standards that would increase the capital requirements of banks. It is unclear whether the federal banking agencies will apply the “Basel III” standards to all banks, or only to the largest banks.

B. Bank Lending Limits Changed to Restrict Credit Exposure to Derivatives

The total outstanding extensions of credit of a national bank or a savings association to one borrower generally may not exceed 15 percent of capital and surplus, plus an additional 10 percent of capital and surplus, if the amount that exceeds the 15 percent general limit is fully secured.
by readily marketable collateral. 21 “Readily marketable collateral” means “financial instruments and bullion that are salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market.” 22 To qualify for the additional 10 percent limit, the insured depository institution must perfect a security interest in the collateral and the collateral must have a current market value of at least 100 percent of the amount of the loan exceeding the amount of the extension of credit.

DFA § 610 requires that, starting on July 21, 2012, lending limits for national banks and federal savings associations apply to any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between a national bank and the person. 23

A “derivative transaction” is defined to include “any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.” 24

Beginning January 21, 2012, DFA § 611 prohibits a state-chartered bank from engaging in a derivative transaction unless “the law with respect to lending limits of the State in which the insured State bank is chartered takes into consideration credit exposure to derivative transactions.” 25

21. 12 U.S.C. § 84; 12 C.F.R. §§ 32.3(a) (national banks) and 560.93(b) (federal savings associations).
22. 12 C.F.R. §§ 32.2(n) (national banks) and 560.93(b) (federal savings associations).
23. DFA § 610(a) amended Revised Statutes § 5200(b) defines “loans and extensions of credit” to include “(A) all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds or repayable from specified property pledged by or on behalf of the person; (B) and, to the extent specified by the Comptroller of the Currency, such term shall also include any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment; and (C) any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the national banking association and the person.”
24. DFA § 610(a); 12 U.S.C. § 84(b)(3).
C. “Volcker Rule” Restricting Proprietary Trading and the Sponsoring and Investment in Hedge and Private Equity Funds

DFA § 619 requires that, effective the earlier of twelve months after issuance of regulations or July 21, 2012, “banking entities” (which are defined as insured depository institutions—other than limited purpose trust companies—and their holding companies, affiliates, and subsidiaries) will be subject to certain restrictions with respect to engaging in certain types of proprietary trading and sponsoring or having any ownership interest in a hedge fund or a private equity fund.\(^\text{26}\) DFA § 619 has been nicknamed the “Volcker Rule” because it is based upon a proposal by Paul Volcker (who served as the chairman of the Federal Reserve Bank from 1979 to 1987) to prohibit proprietary trading activities of insured depository institutions and their affiliates.

On October 11, 2011, the FRB published proposed regulations to implement the Volcker Rule provisions of DFA § 619, titled “Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds.” The proposed regulations were jointly agreed upon by the FRB (to be set forth in 12 C.F.R. Part 248), FDIC (to be set forth in 12 C.F.R. Part 351), OCC (to be set forth in 12 C.F.R. Part 44) and SEC (to be set forth in 12 C.F.R. Part 255). The proposed regulations have a public comment period that ends on January 13, 2012.

Restrictions on Proprietary Trading. Proposed 12 C.F.R. § 248.3(a) prohibits a “covered banking entity” from engaging in “proprietary trading” after July 21, 2014. However, the FRB, in its discretion, may provide a covered banking entity with (i) up to three additional one year extensions, if the proprietary trading activity is not an illiquid fund, and (iii) an additional extension of up to five additional years, in the event that the banking entity owns an “illiquid fund” or the ownership of the private equity fund or hedge fund is “necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.”\(^\text{27}\)

Proposed 12 C.F.R. § 248.2(e) defines a “banking entity” as (i) any insured depository institution (except for an institution that engages solely in a trust or fiduciary capacity, in accordance with 12 U.S.C.

\(^\text{26}\) DFA § 619 (to be codified at 12 U.S.C. § 1851).

§ 1841(c)(2)(D)), (ii) any company that controls an insured depository institution, (iii) any foreign bank or foreign bank holding company that maintains a bank branch, agency office or commercial lending company in the United States, and (iv) any affiliate or subsidiary of an insured depository institution, except for an affiliate or subsidiary that is an exempt “covered fund.” Proposed 12 C.F.R. § 248.2(a) defines an entity as being an “affiliate” when a covered banking entity has the power to vote 25% or more of any class of a company’s voting securities, has the power to elect a majority of the directors of the company, or has been determined by the FRB to exercise a controlling influence over the management or policies of the company.

Proposed 12 C.F.R. § 248.3(b)(1) defines “proprietary trading” as “engaging in principal for the trading account of the covered banking entity in any purchase or sale of one or more covered financial positions.” Proposed 12 C.F.R. § 248.3(b)(3)(i) defines “covered financial position” as any long, short, synthetic or other position, in (i) a security, including an option on a security, (ii) a derivative, including an option on a derivative, or (iii) a contract of sale of a commodity for future delivery, or an option on a contract of sale of a commodity for future delivery.\(^{28}\) Proposed 12 C.F.R. § 248.3(b)(3)(ii) specifically exempts from the definition of “covered financial position” any position that is a loan, commodity, or foreign exchange or currency.

The following activities are specifically exempted from the definition of “proprietary trading”: (i) the purchase or sale of government obligations issued by the U.S. government, a U.S. government agency, any state or municipal government, Ginnie Mae, Fannie Mae, Freddie Mac, any Federal Home Loan Bank, or Farmer Mac (proposed 12 C.F.R. § 248.6(a)); (ii) the purchase or sale of a covered financial position in connection with underwriting and market-making for near-term demands of clients (proposed 12 C.F.R. § 248.4(a)(1)); (iii) the purchase or sale of a covered financial position that is designed to reduce the specific risks to the covered banking entity in connection with positions, contracts or other holdings (proposed 12 C.F.R. § 248.5(a)); (iv) the purchase or sale of a covered financial position on behalf of customers (proposed 12 C.F.R. § 248.6(b)); (v) the purchase or sale of a covered financial position by an insurance company for the account of the insurance company,

subject to restrictions placed by state insurance commissioners and the FRB (proposed 12 C.F.R. § 248.6(c)), or (vi) the purchase or sale of a covered financial position by a covered banking entity outside the United States, if the covered banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or one or more states (proposed 12 C.F.R. § 248.6(d)).

Proposed 12 C.F.R. § 248.8(a) prohibits a covered banking entity from engaging in even the expressly permitted proprietary trading activities, if such activities would (i) involve or result in “a material conflict of interest between the covered banking entity and its clients, customers, or counterparties,” (ii) result in “a material exposure by the covered banking entity to a high-risk asset or high-risk trading strategy,” or (iii) “pose a threat to the safety and soundness of the covered banking entity or the financial stability of the United States.”

Restrictions on Ownership or Sponsorship of Hedge and Private Equity Funds. Proposed 12 C.F.R. § 248.10(a) also prohibits, subject to certain exemptions, a covered banking entity from sponsoring or having a controlling interest in a “covered fund.” Proposed 12 C.F.R. § 248.10(b)(1) defines a “covered fund” to mean (i) any issuer of securities that would be an investment company, but for the exemptions set forth in Investment Company Act § 3(c)(1) (which exempts funds owned by 100 or fewer purchasers) and Investment Company Act § 3(c)(7) (which exempts funds owned solely by “qualified purchasers,” as defined in Investment Company Act § 2(a)(51)), (ii) a commodity pool, as defined in 7 U.S.C. § 1a(10), (iii) any issuer of securities that would be a “covered fund” if it were organized and offered under the laws, or offered to one or more residents, of the United States or of one or more states, and (iv) any such similar fund as the appropriate federal banking agencies, the SEC and the CFTC may determine, by regulation.

The definition of “covered fund” excludes (i) the organization and offering of a covered fund solely in connection with the provision of bona fide trust, fiduciary, investment advisory or commodity trading advisory services, to persons that are customers of such services of the covered banking entity, and subject to certain other significant restrictions (proposed 12 C.F.R. § 248.11), (ii) investments made in small business investment companies, public welfare investments or qualified

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rehabilitation investments (proposed 12 C.F.R. § 248.13(a)), (iii) an ownership interest in a covered fund that is designed to reduce the specific risks to the covered banking entity in connection with the obligations or liabilities of the covered banking entity, subject to certain other significant restrictions (proposed 12 C.F.R. § 248.13(b)), (iv) any proprietary trading or ownership interest in a covered fund that occurs outside the United States by a banking entity that is not directly or indirectly controlled by a covered banking entity that is organized under United States federal or state law (proposed 12 C.F.R. § 248.13(c), (v) loan securitizations (proposed 12 C.F.R. § 248.13(d)), (vi) a separate account established by an insurance company for a bank which is used solely for the purpose of purchasing bank owned life insurance, provided that the banking entity does not control the investment decisions regarding the underlying assets or holdings of the separate account (proposed 12 C.F.R. § 248.14(a)(1)), (vii) a joint venture between a covered banking entity and one or more of its affiliates (proposed 12 C.F.R. § 248.13(a)(2)(i)), (viii) an acquisition vehicle (proposed 12 C.F.R. § 248.13(a)(2)(ii)), (ix) an issuer of an asset-backed security, but only with respect to the portion of the credit risk for an asset-backed security that must be retained by a covered banking entity in compliance with the minimum requirements of 15 U.S.C. § 78o-11 (proposed 12 C.F.R. § 248.13(a)(2)(iii)), (x) a wholly-owned subsidiary of the covered banking entity that is engaged principally in performing a bona fide liquidity management activity, subject to certain other restrictions (proposed 12 C.F.R. § 248.13(a)(2)(iv)) and (xi) a covered fund that is an issuer of asset backed securities that are solely comprised of loans, contractual rights or assets arising from the loans, and interest rate or foreign exchange derivatives that relate to the loans and are used for hedging purposes (proposed 12 C.F.R. § 248.13(a)(2)(v)).

DFA § 619(d)(4) and proposed 12 C.F.R. § 248.12 also contain covered fund seeding and de minimis exemptions that permit a banking entity to have an ownership interest in a covered fund that the banking entity organizes and offers, if the investment in the hedge fund that does not exceed (i) 3% of the tier 1 capital of the covered banking entity and (ii) after one year after the date of the establishment of the fund (subject to a discretionary two year extension by the FRB), does not

exceed more than 3% of the total ownership interests in the fund and is not exposed to more than 3% of the losses of the covered fund.32

Proposed 12 C.F.R. § 248.17(a) prohibits a covered banking entity from engaging in even the expressly permitted covered fund activities, if such activities would (i) involve or result in “a material conflict of interest between the covered banking entity and its clients, customers, or counterparties,” (ii) result in “a material exposure by the covered banking entity to a high-risk asset or high-risk trading strategy,” or (iii) “pose a threat to the safety and soundness of the covered banking entity or the financial stability of the United States.”

**Affiliate Transaction Restrictions.** Under proposed 12 C.F.R. § 248.16(a)(1), if a covered banking entity serves as (i) the investment manager, investment advisor, commodity trading advisor, or sponsor to a covered fund, or (ii) organizes and offers a covered fund, then the covered banking entity and its affiliates are prohibited from conducting any extensions of credit or other transactions that would be deemed to be a “covered transaction” under the affiliate transaction restrictions of Federal Reserve Act § 23A.33 However, proposed 12 C.F.R. § 248.16(a)(2)(ii) exempts any “prime brokerage transaction” between a covered fund and an affiliate from such affiliate transactions restrictions. A “prime brokerage transaction” is defined by proposed 12 C.F.R. § 248.10(b)(4) as “one or more products or services provided by a covered banking entity to a covered fund, such as custody, clearance, securities borrowing or lending services, trade execution or financing, data, operational, and portfolio management support.”

Proposed 12 C.F.R. § 248.16(b) and (c) also apply the affiliate transaction restrictions of Federal Reserve Act § 23B (12 U.S.C. § 371c-1) to affiliate transactions with covered funds (including prime brokerage transactions). Federal Reserve Act § 23B generally requires that an affiliate transaction be on market terms or on terms at least as favorable to the banking entity as a comparable transaction by the banking entity with an unaffiliated third party.

**Compliance Program.** Appendix C of proposed 12 C.F.R. Part 248 requires that each covered banking entity that engages in proprietary trading and covered fund activities must establish a compliance

program that includes (i) written internal policies and procedures that are approved by the Board of Directors of the covered banking entity, (ii) internal controls that properly monitor the compliance program, (iii) a management framework for compliance responsibility and accountability, (iv) independent testing of the compliance program, (v) training of appropriate personnel to implement the compliance program, and (vi) recordkeeping that is sufficient to demonstrate compliance with the DFA § 619 and the proposed regulations.

Effects of Proposed 12 C.F.R. Part 248. Management of securities broker-dealers and insurance companies that are affiliated with insured depository institutions will need to evaluate carefully whether the activity restrictions and compliance requirements set forth in proposed 12 C.F.R. Part 248 create costs that outweigh the benefits of their continued affiliation. It is possible that certain banking entities will respond to the final version of these regulations by divesting themselves of their insured depository institution affiliates in order to avoid being subject to the restrictions of the Volcker Rule.

D. Restrictions on Charter Changes for Troubled Institutions

DFA § 612 generally prohibits national banks and federal savings associations from converting to state charters and state-chartered banks and savings associations from converting to national banks or federal savings associations if the depository institution seeking conversion is subject to a cease and desist order, other formal enforcement order, or memorandum of understanding. However, DFA § 612(d) permits approval of a conversion in this instance if (i) the proposed successor federal banking agency provides the appropriate federal banking agency or state bank supervisor written notice of the planned conversion that includes a plan to address the significant supervisory matter, (ii) the appropriate federal banking agency or state bank supervisor that issued the cease and desist order does not object to the conversion or plan, (iii) after conversion, the appropriate federal banking agency implements the plan, and (iv) in the case of a final enforcement action by a state attorney general, approval of the conversion is conditioned on compliance by the insured depository institution with the terms of the final enforcement action.

E. FRB Authorized to Increase Regulation of Certain Nonbank Affiliates of Bank Holding Company

Prior to July 21, 2011, the Bank Holding Company Act § 5(c)(2) significantly restricted the examination authority of the FRB with respect to nonbank subsidiaries of a bank holding company (BHC) and placed additional restrictions on the FRB’s examination authority with respect to “functionally regulated” nonbank subsidiaries of a bank holding company, such as a securities broker-dealer (which is functionally regulated by the Securities and Exchange Commission [SEC]) or an insurance underwriter (which is functionally regulated by a state insurance commissioner).

DFA § 604, which became effective July 21, 2011, terminates most of the Bank Holding Company Act § 5(c)(2) restrictions on FRB examination authority with respect to nonbank subsidiaries of a bank holding company. The FRB is now authorized to examine a nonbank affiliate not only for safety and soundness risks but also for “other risks within the bank holding company system” that may pose a threat to “safety and soundness” and “the stability of the financial system in the United States.”

The FRB can also require that a nonbank subsidiary of a bank holding company provide to the FRB regulatory reports and supervisory information from other regulators, externally audited financial statements, and public reporting information. Furthermore, the FRB is permitted to monitor the compliance of a bank holding company’s nonbank subsidiary (unless it is a functionally regulated subsidiary) with respect to any federal law.

F. “Living Wills” for Banks with $50 Billion or More in Assets

DFA § 165(d)(1) requires that bank holding companies with $50 billion or more in total consolidated assets to provide the FRB, the FDIC, and the Financial Stability Oversight Counsel (FSOC) a resolution plan for the rapid and orderly resolution of such bank holding company in the event of material financial distress or failure. The resolution plan must include (i) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company; (ii) a full descriptions of the ownership structure,

assets, liabilities, and contractual obligation of the company; (iii) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and (iv) any other information that the FRB and the FDIC jointly require by rule or order.

On October 17, 2011, the FRB and the FDIC jointly published final regulations for DFA § 165(d)(1), which became effective on November 30, 2011. The regulations are codified at 12 C.F.R. Part 243 (regulations of the FRB) and 12 C.F.R Part 381 (regulations of the FDIC). The regulations cover “covered companies,” which are (i) any bank holding company “that has $50 billion or more in total consolidated assets, as determined based on the average of the company’s most recent Consolidated Financial Statements for Bank Holding Companies as reported on the Federal Reserve’s Form FR Y-9C, (ii) “any foreign bank or company that is a bank holding company or is treated like a bank holding company under section 8(a) of the International Banking Act of 1978” that has $50 billion or more in total consolidated assets, as determined based on the foreign bank’s or company’s most recent annual, or as applicable, the average of the four most recent quarterly Form FR Y-7Q reports and (iii) any “nonbank financial company” that FSOC has determined, under DFA § 113, to be subject to the mandatory supervision of the FRB.38

Under 12 C.F.R. § 243.3(a), covered companies are required to file initial resolution plans with the FRB and FDIC by the following deadlines: (i) July 1, 2012, for covered companies with $250 billion or more in total nonbank assets, (ii) July 1, 2013, for covered companies with $100 billion or more in total nonbank assets and (iii) December 31, 2013 for covered companies with less than $100 billion in total nonbank assets. A company that becomes a covered company after November 30, 2011 must submit an initial resolution plan no later than “July 1 following the date the company becomes a covered company, provided such date occurs no earlier than 270 days after the date on which the company became a covered company.”39

The informational content for a resolution plan is set forth in 12 C.F.R. § 243.4, and such plans are subject to the joint review and approval of the FRB and FDIC.

38. 12 C.F.R. § 243.2(f).
IV. MERGER AND ACQUISITION RESTRICTIONS

The DFA places additional restrictions on mergers involving banks, savings associations, and their holding companies.

A. Nationwide 10 Percent Concentration Limits for Acquisitions

DFA § 622 prohibits a financial company from merging or consolidating with, acquiring all or substantially all of the assets of, or otherwise acquiring control of another company if the total consolidated liabilities of the acquiring financial company upon consummation of the transaction would exceed 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction. 40 The 10 percent concentration limit can be waived with the prior written consent of the FRB if (i) there is an acquisition of a bank in default or in danger of default, (ii) assistance is being provided by the FDIC under § 13(c) of the Federal Deposit Insurance Act (12 U.S.C. § 1823(c)), or (iii) the acquisition would result in a de minimis increase in the liabilities of the financial company.

On February 8, 2011, FSOC published its recommendations with respect to DFA § 622, which included (i) modifying the statutory definition of “liabilities” for certain companies that do not currently calculate or report risk-weighted assets; (ii) modifying the calculation of aggregate financial sector liabilities to use a two-year rolling average instead of a single year for purposes of calculating the denominator of the limit and requiring the Board to publicly report on an annual basis and no later than July 1 of any calendar year a final calculation of the aggregate consolidated liabilities of all financial companies as of the end of the preceding calendar year; and (iii) extending the exception provided in the statute for the acquisition of failing banks to other failing insured depository institutions of the financial company. 41

In addition, DFA § 623(a) prohibits a merger between insured depository institutions if it would result in an insured depository institution (including all insured depository institutions which are affiliates of the resulting insured depository institution), upon consummation of the transaction, controlling more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

40. DFA § 622 creates a new § 14 of the Bank Holding Company Act.
B. Bank Holding Companies and Banks Must Be Well Capitalized and Well Managed to Engage in Interstate Bank Acquisitions

Prior to the DFA, interstate bank acquisitions were permitted if the acquiring bank holding company was adequately capitalized and the resulting bank would be adequately capitalized and adequately managed upon consummation of the transaction.

DFA § 607 increases the capital standards for interstate bank acquisitions by requiring that both the bank holding company and the resulting bank be well capitalized and well managed.\textsuperscript{42}

C. Financial Holding Company Must Be Well Capitalized and Well Managed to Acquire Financial Subsidiaries

Prior to the enactment of the DFA, a bank holding company could elect to become a financial holding company (FHC) if it had well-capitalized and well-managed bank subsidiaries but was itself only adequately capitalized. The FHC could then acquire companies that engage in additional activities that are not permitted under Bank Holding Company Act § 4(c)(8). The additional activities permitted for an FHC include insurance underwriting, less restricted securities underwriting, and merchant banking investments.\textsuperscript{43}

DFA § 606(a) amends Bank Holding Company Act § 4(l)(1) to require that an FHC have and maintain a classification of “well capitalized” and “well managed.”\textsuperscript{44} As the FRB is now the regulatory authority for savings and loan holding companies, DFA § 606(b) makes a conforming change to Home Owners’ Loan Act § 10(c)(2) to apply the well-capitalized and well-managed requirement on savings and loan holding companies that engage in activities that are not permitted under Bank Holding Company Act § 4(c)(8).\textsuperscript{45}

D. Three-Year Statutory Moratorium on Nonbank Banks

Industrial banks (a large number of which are chartered in the state of Utah), credit card banks, and certain types of trust banks are unique in that they can be owned by, or affiliated with, nonfinancial companies.

\textsuperscript{42} 12 U.S.C. §§ 1831u(b)(4)(B) (interstate bank merger) and 1842(d)(1)(A) (interstate bank acquisition by holding company).

\textsuperscript{43} 12 C.F.R. § 225.86 (activities permissible for a financial holding company).

\textsuperscript{44} 12 U.S.C. § 1843(d)(1)(A).

\textsuperscript{45} 12 U.S.C. 1467a(c)(2)(H).
In contrast, banks and savings associations, whether state or federally chartered, cannot be affiliated with nonfinancial companies.

DFA § 603(a)(2) prohibits the FDIC from approving a deposit insurance application received after November 23, 2009 for an industrial bank, credit card bank, or trust bank that would be directly or indirectly owned by a commercial firm.46 A company is a “commercial firm,” for purposes of DFA § 603(a)(2) if less than 15 percent of its consolidated annual gross revenues are derived from activities that are financial in nature (as defined in the Bank Holding Company Act § 4(k) (12 U.S.C. § 1843(k)) and, if applicable, from the ownership or control of one or more insured depository institutions. This moratorium on new industrial, credit card, and trust bank charters expires on July 21, 2013.

DFA § 603(a)(3) also prohibits until July 21, 2013, any federal banking agency approving a change in control that would result in direct or indirect control of an industrial, credit card, or trust bank by a commercial firm. This prohibition, however, is subject to the following exceptions: (i) the industrial, credit card, or trust bank is in danger of default as determined by the appropriate federal banking agency; (ii) the change in control results from the merger or whole acquisition of a commercial firm that directly or indirectly controls the entity in a bona fide merger with, or acquisition by, another commercial firm, as determined by the appropriate federal banking agency; or (iii) the change in control results from an acquisition of voting shares of a publicly traded company that controls the entity if, after the acquisition, the acquiring shareholder or group of shareholders acting in concert hold less than 25 percent of any class of the voting shares of the company.

V. TRANSACTION AND ACTIVITY RESTRICTIONS

The DFA contains provisions, which became effective on July 21, 2011, that significantly narrowed the scope of preemptions available for national banks and federal savings associations.

46. See 12 U.S.C. §§ 1841(c)(2)(F) (credit card bank definition), 1841(c)(2)(H) (industrial bank definition), and 1841(c)(2)(D) (trust bank definition).
A. Limitations on Preemption of State Laws for National Banks and Federal Savings Associations

Prior to the enactment of the DFA, both the Office of the Comptroller of the Currency (OCC) (with respect to national banks) and the OTS (on behalf of federal savings associations) concluded that certain provisions of the National Bank Act and the Home Owners’ Loan Act preempted certain state consumer laws that applied to bank products. Consequently, national banks and federal savings banks did not have to comply with certain state consumer law requirements that applied to state-chartered banks.

1. DFA Preemption Reform
The DFA sets forth the following primary preemption restrictions.

- **Preemption Standards of Federal Savings Associations Are Restricted to Those of National Banks.** DFA § 1046 conforms the preemption standards for federal savings associations to those of national banks. DFA § 1046 creates a new Home Owners Loan Act § 6(a) that states as follows: “Any determination by a court or by the Director or any successor officer or agency regarding the relation of State law to a provision of this Act or any regulation or order prescribed under this Act shall be made in accordance with the laws and legal standards applicable to national banks regarding the preemption of State law.”

- **Operating Subsidiaries Lose Their Preemption.** DFA § 1045 precludes preemption of state law for activities conducted by national bank subsidiaries, agents, and affiliates. DFA § 1045 states as follows: “No provision of this title or section 24 of the Federal Reserve Act shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate or agent of a national bank (other than a subsidiary, affiliate or agent that is chartered as a national bank).”

DFA § 1045 deliberately overrides the decision of *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007), under which the U.S. Supreme Court had affirmed the OCC’s preemption of state law with respect to the licensing of mortgage company subsidiaries of a national bank.

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48. Revised Statutes § 5136C(e).
• **Preemption of State Consumer Financial Laws Is Restricted.** DFA § 1044 provides that state consumer financial laws may be preempted only if “(A) application of a State consumer financial law would have a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that State; (B) in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996), the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law; or (C) the State consumer financial law is preempted by a provision of Federal law other than this title.”

A “state consumer financial law” means a “State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized by national banks to engage in), or any account related thereto, with respect to a consumer.”

• **OCC Must Make Case-by-Case Preemptions of State Consumer Financial Laws.** The DFA imposes new procedures and consultation requirements with respect to how the OCC may reach certain preemption determinations and sets forth the criteria for judicial review of these determinations. Specifically, DFA § 1044 requires that the OCC make preemption determinations with regard to state consumer financial laws under the *Barnett* standard by regulation or order on a case-by-case basis in accordance with applicable law. DFA § 1044 defines “case-by-case basis” as “a determination pursuant to this section made by the Comptroller concerning the impact of a particular State consumer financial law on any national bank that is subject to that law, or the law of any other State with substantively equivalent terms.”

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49. Revised Statutes § 5136C(b).
50. Revised Statutes § 5136C(a)(2).
• Consultation Required with Bureau of Consumer Financial Protection (the “Bureau”) on Preemption of State Consumer Financial Laws. DFA § 1044 states as follows: “When making a determination on a case-by-case basis that a State consumer financial law of another State has substantively equivalent terms as one that the Comptroller is preempting, the Comptroller shall first consult with the Bureau of Consumer Financial Protection and shall take the views of the Bureau into account when making the determination.”

• Visitorial Powers Do Not Conflict with Certain Rights of State Attorneys General. DFA § 1047 states as follows: “In accordance with the decision of the Supreme Court of the United States in Cuomo v. Clearing House Assn., L.L.C. (129 S. Ct. 2710 (2009)), no provision of this title which relates to visitorial powers or otherwise limits or restricts the visitorial authority to which any national bank is subject shall be construed as limiting or restricting the authority of any attorney general (or other chief law enforcement officer) of any State to bring an action against a national bank in a court of appropriate jurisdiction to enforce an applicable law and to seek relief as authorized by such law.”

DFA § 1043 appears to have attempted to ameliorate problems related to national banks and federal savings associations having entered into contracts that were based upon the pre-DFA preemption regulations. DFA § 1043 states as follows: “This title, and regulations, orders, guidance, and interpretations prescribed, issued, or established by the Bureau, shall not be construed to alter or affect the applicability of any regulation, order, guidance, or interpretation prescribed, issued, and established by the Comptroller of the Currency or the Director of the Office of Thrift Supervision regarding the applicability of State law under Federal banking law to any contract entered into on or before the date of enactment of this Act, by national banks, Federal savings associations, or subsidiaries thereof that are regulated and supervised by the Comptroller of the Currency or the Director of the Office of Thrift Supervision, respectively.”

52. Revised Statutes § 5136C(b)(3)(B).
53. Revised Statutes § 5136C(i)(1).
2. OCC Regulations Implementing DFA Preemption Reforms

The OCC revisions to its preemption regulations were set forth in Subpart D of 12 C.F.R. pt. 7.54 The OCC amendments to its regulations included the following:

- **Visitorial Powers.** The OCC expressly recognized the right of state attorney generals under 12 C.F.R. § 7.4000(b), to engage in enforcement actions with respect to certain state laws: “In accordance with the decision of the Supreme Court in *Cuomo v. Clearing House Assn.*, L.L.C., 129 S. Ct. 2710 (2009), an action against a national bank in a court of appropriate jurisdiction brought by a state attorney general (or other chief law enforcement officer) to enforce an applicable law against a national bank and to seek relief as authorized by such law is not an exercise of visitorial powers under 12 U.S.C. 484.”

- **Operating Subsidiaries.** The OCC removed 12 C.F.R. § 7.4006, which was its operating subsidiary preemption regulation. The regulation had previously stated: “Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.”

- **Deposit-Taking.** The OCC added a new opening sentence to 12 C.F.R. § 7.4007(c), which states: “State laws on the following subjects are not inconsistent with the deposit-taking powers of national banks and apply to national banks to the extent consistent with the decision of the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.* 517 U.S. 25 (1996).” The OCC also replaced in 12 C.F.R. § 7.4007(c) (8) the “incidental to deposit-taking” justification for preemption with the following: “Any other law that the OCC determines to be applicable to national banks in accordance with the decision of the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.* 517 U.S. 25 (1996), or that is made applicable by Federal law.”

- **Lending.** The OCC removed 12 C.F.R. § 7.4008(d)(1), which stated as follows: “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 powers are not applicable to national banks.” The OCC inserted the same Barnett language into the lending preemption regulation as had been added to the deposit-taking regulation.


- **Applicability of State Law and Visitorial Powers to Federal Savings Associations.** The OCC conformed the preemption of federal savings associations to national banks by creating new language in 12 C.F.R. § 7.4010, which states as follows: “In accordance with section 1046 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 25b), Federal savings associations and their subsidiaries shall be subject to the same laws and legal standards, including regulations of the OCC, as are applicable to national banks and their subsidiaries, regarding the preemption of state law. . . . In accordance with section 1047 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 1465), the provisions of section 5136C(i) of the Revised Statutes regarding visitorial powers apply to Federal savings associations and their subsidiaries to the same extent and in the same manner as if they were national banks or national bank subsidiaries.”

3. Controversy Over Whether OCC Revised Preemption Regulations Followed Restrictions of DFA § 1044

The OCC’s revised preemption regulations have been criticized by some, because there is a concern that they remain broader in scope than what was otherwise permitted under the Barnett standard and the “case by case” determination requirement prescribed by DFA § 1044. This criticism did not go unnoticed by the OCC. Indeed, the OCC noted in its comments on its revised preemption regulations that commenters opposed to the new regulations argued that (i) the DFA “adopts a new preemption standard, narrower than the Barnett decision’s ‘conflict’ preemption analysis,” (ii) every portion of the preemption rules originally adopted by the OCC in 2004 were implicitly repealed by the DFA, and (iii) the “preemption of categories and/or terms of state laws is equivalent to ‘occupation of the field,’ rather than conflict, preemption.”

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55. The Credit Union National Association (CUNA), the Clearing House Association LLC, American Bankers Association, Consumer Bankers Association,
Prior to the enactment of the DFA, courts, when reviewing OCC preemption decisions, applied the deference standard set forth in *Chevron v. National Resources Defense Council*, 467 U.S. 837, 842 (1984), which had held that an interpretive rule of a federal agency will be upheld if (i) Congress has not “directly addressed the precise question at issue” and (ii) the rule is not “arbitrary, capricious or manifestly contrary to the statute.” (The *Chevron* case is discussed further in Chapter 9.)

DFA § 1044 required that a “court reviewing any determinations made by the Comptroller regarding preemption of a State law . . . shall assess the validity of such determinations, depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision.” This language found in DFA § 1044 is an almost verbatim recitation of the narrower standard of judicial deference that was set forth by the U.S. Supreme Court in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), which was based upon a dispute over an administrator’s interpretation of the Fair Labor Standards Act.

**B. Electronic Debit Card Transactions**

DFA § 1075, which is also known as the “Durbin Amendment,” created a new § 920 of the Electronic Fund Transfer Act (15 U.S.C. § 1693, et seq.) to authorize the FRB to set the maximum amount of the interchange transaction fee an issuer may charge for an electronic debit transaction. DFA § 1075 requires that the FRB issue regulations to prohibit insured depository institutions and payment card networks from inhibiting the ability of any merchant accepting debit cards to provide discounts or set minimum dollar values for the acceptance of debit cards or incentives to use nondebit cards.

On July 20, 2011, the FRB published Regulation II, the final Debit Card Interchange Fees and Routing regulations for Electronic Funds Transfer Act § 920, which is set forth in 12 C.F.R. pt. 235. The final rules are effective October 21, 2011.


Under 12 C.F.R. § 235.3(b), an issuer (i.e., a person or entity that authorizes the use of a debit card to perform an electronic debit transaction) complies with the “reasonable and proportional” interchange transaction fee requirement if each interchange transaction fee received or charged by the issuer for an electronic debit transaction is no more than the sum of 21 cents (the base component) and five basis points multiplied by the value of the transaction (the *ad valorem* component). Furthermore, an issuer may not receive net compensation from a payment card network with respect to electronic debit transactions or debit card-related activities within a calendar year.\[^{58}\] Net compensation occurs when the total amount of payments or incentives received by an issuer from a payment card network with respect to electronic debit transactions or debit card-related activities, other than interchange transaction fees passed through to the issuer by the network, during a calendar year exceeds the total amount of all fees paid by the issuer to the network with respect to electronic debit transactions or debit card-related activities during the calendar year. However, as set forth in 12 C.F.R. § 235.5(a)(ii), an issuer is exempt from the interchange transaction fee caps and the net compensation prohibition if (i) the issuer holds the account of the debited and (ii) the issuer, together with its affiliates, has assets of less than $10 billion as of the end of the calendar quarter preceding the date of the electronic debit transaction.

**Limitations on Payment Card Restrictions.** Under 12 C.F.R. § 235.7(a), issuers and payment card networks are prohibited from restricting “the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks.”\[^{59}\]

**Prohibition on Exclusivity Arrangements by Networks.** A payment card network may not restrict or otherwise limit an issuer’s ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer’s debit cards.\[^{60}\] Examples of prohibited exclusivity arrangements include (i) network rules or contract provisions limiting or otherwise restricting the other payment card networks that may be enabled on a particular debit card, or network rules or contract provisions that specify the other networks that may be enabled on a particular debit card and (ii) network rules or guidelines

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*Footnotes:*

58. 12 C.F.R. § 235.6(b).
59. 12 C.F.R. § 235.7(a).
60. 12 C.F.R. § 235.7(a)(3).
that allow only that network’s (or its affiliated network’s) brand, mark, or logo to be displayed on a particular debit card, or that otherwise limit the ability of brands, marks, or logos of other payment card networks to appear on the debit card.\(^{61}\)

The deadlines for complying with 12 C.F.R. § 235.7(a)(1) and (3) are (i) October 1, 2011, for payment card networks; (ii) April 1, 2013, for debit cards that use point-of-sale transaction qualification or substantiation systems for verifying the eligibility of purchased goods or services; (iii) April 1, 2013, for nonreloadable general-use prepaid cards (with nonreloadable general-use prepaid cards sold prior to April 1, 2013, not being subject to the limitations on payment card restrictions); (iv) April 1, 2013, for reloadable general-use prepaid cards (with reloadable general-use prepaid cards sold prior to April 1, 2013, not being subject to the limitations on payment card restrictions unless and until they are reloaded); (v) May 1, 2013, for reloadable general-use prepaid cards sold and reloaded prior to April 1, 2013; and (vi) thirty days after the date of reloading for reloadable general-use cards sold prior to April 1, 2013, and reloaded on or after April 1, 2013.

**Prohibition on Routing Restrictions.** An issuer or payment card network may not inhibit the ability of any person or entity that accepts or honors debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.\(^{62}\) The compliance date for this prohibition is April 1, 2012.

**Fraud Prevention Adjustment.** The FRB simultaneously issued an interim final rule, set forth in 12 C.F.R. § 235.4, allowing an issuer who meets certain issuer standards to receive or charge an additional amount of no more than 1 cent per transaction to any interchange transaction fee it receives or charges.\(^{63}\) In order to meet the issuer standards, the issuer must have (i) developed, implemented, and updated policies and procedures reasonably designed to identify and prevent fraudulent electronic debit transactions, including monitoring the incidence of, reimbursements received for, and losses incurred from, fraudulent electronic debit transactions; (ii) responded appropriately to suspicious electronic debit transactions to limit the fraud losses that may occur and prevented

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\(^{62}\) 12 C.F.R. § 235.7(b).

the occurrence of future fraudulent electronic debit transactions; and
(iii) secured debit card and cardholder data. If an issuer meets these
standards and wishes to receive the fraud-prevention adjustment, it must
so certify its eligibility to receive the fraud-prevention adjustment to the
payment card networks in which the issuer participates.

Legal Challenge to DFA § 1075. On October 12, 2010, TCF
National Bank filed a lawsuit against the FRB and the OCC in the U.S.
District Court of South Dakota that alleged that the debit card inter-
change fee caps of DFA § 1075 were unconstitutional and sought a pre-
liminary injunction against them. On April 25, 2011, the District Court
denied the motion of TCF National Bank for a preliminary injunction.
On June 29, 2011, the Eighth Circuit Court of Appeals affirmed the
District Court’s denial of the preliminary injunction.65

The Eighth Circuit Court of Appeals, in rejecting TCF National
Bank’s constitutional claims that the fee caps constituted an uncom-
pensated taking that violated substantive due process protections, held
as follows:

Since TCF is free under the Durbin Amendment to assess fees on
its customers to offset any losses under the Durbin Amendment, we
are skeptical that the Durbin Amendment has even created a suf-
cient price control on TCF’s debit-card business so as to trigger
a confiscatory-rate analysis or that the law could, in fact, produce a
confiscatory rate. Indeed, the heart of any confiscatory-rate claim is
the ability to show that the government has set a maximum price for
a good or service and that the rate is below the cost of production
(factoring in a reasonable rate of return), which TCF has simply not
shown on this record.

The Eighth Circuit Court of Appeals also rejected TCF National Bank’s
claim that the fee cap exemption for banks with fewer than $10 billion in
assets violated the equal protection clause. Applying the “rational basis
doctrine,” the court held as follows:

[T]he Durbin Amendment’s distinction between larger and smaller
issuers of debit cards is rationally related to the government’s legiti-
mate interests in protecting small banks, which do not enjoy the

64. See 12 C.F.R. § 235.4(b).
competitive advantage of their larger counterparts and which provide valuable diversity in the financial industry, and in ensuring consumer access to debit cards.

On June 30, 2011, TCF National Bank ceased its fight against the debit card interchange fee caps by voluntarily dismissing its lawsuit.

**Effects of Regulation II.** The FRB’s data suggest that the average debit interchange rates will decline from 1.14 percent to approximately 0.63 percent. The effect on an average per transaction basis is estimated at a decline from around 44 cents to 24 cents. Some issuers sought to increase fees on other bank products to try to make up for the loss in revenue caused by the interchange debit fee cap.

Overall, debit card issuers should review existing arrangements with payment card networks in light of the exclusivity prohibition provisions of the FRB’s regulations. The total amount of compensation provided by the network to the issuer—such as rebates, incentives, or payments—cannot exceed the total amount of fees paid by the issuer to the payment card network. Likewise, issuers hoping to collect the additional fraud adjustment must review existing arrangements to ensure their fraud prevention activities are consistent with the FRB’s standards.

The payment card network announcements regarding their implementation plans should be scrutinized, especially by community banks, to determine how best to minimize the financial pinch that the interchange fee cap will likely cause. The FRB at least twice a year will disclose the aggregate or summary information concerning the costs incurred and interchange transaction fees charged or received by issuers or payment card networks in connection with the authorization, clearance, or settlement of electronic debit transactions as it considers appropriate and in the public interest.

C. **Affiliate and Insider Transaction Restrictions**

The DFA contains several provisions that further restrict transactions between an insured depository institution and its affiliates and insiders.

**Affiliate Transaction Restrictions.** Federal Reserve Act §§ 23A (12 U.S.C. § 371c) and 23B (12 U.S.C. § 371c-1) place certain restrictions on covered transactions between a bank or savings association and its nonbank affiliates. A “covered transaction” is when the bank (i) makes a loan to an affiliate, (ii) purchases the securities of an affiliate,
(iii) purchases assets from the affiliate, (iv) accepts securities of an affiliate as collateral for a loan to any person or company, or (v) issues a guarantee, acceptance, or letter of credit on behalf of an affiliate.\footnote{66}

Section 23A, among other things, sets quantitative limits that prohibit the aggregate amount of covered transactions with a single affiliate exceeding 10 percent of the bank’s capital and surplus and with all affiliates exceeding 20 percent of the capital and surplus of the bank.\footnote{67} Section 23A also sets collateral requirements, which require that all extensions of credit by a bank to an affiliate must be secured by specified types of collateral in an amount that ranges from 100 percent to 130 percent of the principal amount of the extension of credit.\footnote{68}

DFA § 608(a)(1) adds to the definition of “affiliate” any investment fund for which a bank is an investment advisor. DFA § 608(b) expands the definition of covered transaction to include (i) the borrowing or lending of securities to the extent that the transaction causes a bank or its subsidiary to have credit exposure to the affiliate; (ii) a derivative transaction with an affiliate to the extent that the transaction causes a bank or its subsidiary to have credit exposure to the affiliate; and (iii) the acceptance of “other debt obligations” issued by an affiliate as collateral security for a loan or extension of credit to any person or company.\footnote{69}

DFA § 609 eliminates the exemption in Federal Reserve Act § 23A(e)(3) from the quantitative limits of Federal Reserve Act § 23A(a)(1)(A) for covered transactions with a financial subsidiary of a bank.\footnote{70} DFA § 608 also amends the term “affiliate” to include investment funds to which a member bank or affiliate is an investment advisor.\footnote{71}

\textbf{Insider Transaction Restrictions.} Federal Reserve Act § 22 is the statute from which insider lending restrictions of Regulation O (12 C.F.R. pt. 215) have been promulgated. DFA § 614 amends the definition of “extension of credit” to include “credit exposure to the person arising from a derivative transaction, . . . repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the member bank and the person.\footnote{72}
D. Funds Availability
DFA § 1086 amends the Expedited Funds Availability Act § 603 to increase from $100 to $200 the amount of deposited funds that institutions must make available for withdrawal by opening of business on the next day.72

E. Diversity Practices Assessments
DFA § 342 requires the FDIC, OCC, National Credit Union Administration, Securities and Exchange Commission, and Consumer Financial Protection Bureau to establish an Office of Minority and Women Inclusion. DFA § 342(b)(2) requires the Director of the Office of Minority and Women Inclusion to “develop standards for assessing the diversity policies and practices of entities regulated by the agency.”73 DFA § 342(b)(4), however, provides that this should not “be construed to mandate any requirement on or otherwise affect the lending policies and practices of any regulated entity, or to require any specific action based on the findings of the assessment.” Consequently, it is not clear at this time what type of data collection or other requirements will be imposed upon insured depository institutions by their appropriate federal banking agencies with respect to this provision of the DFA.

VI. ABOLITION OF THE OTS
The OTS was formed in 1989 as the successor to the Federal Home Loan Bank Board (FHLBB) to regulate federal and state savings associations. The OTS replaced the FHLBB because the FHLBB was thought at that time to be partly responsible for the savings and loan crisis in the 1980s.

A. OTS Functions Transferred to FRB, OCC, and FDIC
By 2010, the OTS was being criticized for providing inadequate supervision to AIG (an insolvent insurance company that was an OTS-regulated savings and loan holding company) and two large federal savings banks that had to be put into receivership, IndyMac Bank and Washington Mutual Bank. Consequently, Title III of the DFA ordered the transfer of OTS powers to other federal banking agencies and the abolition of the OTS no later than October 21, 2011.74

72. DFA § 1086.
73. DFA § 342(b)(2)(C).
74. DFA §§ 311(a) (transfer of functions), 313 (abolition of the OTS).
On July 21, 2011, the powers of the OTS were transferred to other federal banking agencies in the manner set forth in the following table:

<table>
<thead>
<tr>
<th>Federal Banking Agency</th>
<th>OTS Functions Transferred</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRB</td>
<td>All functions relating to (i) the supervision of savings and loan holding companies and their nondepository institution subsidiaries and (ii) rule-making authority with respect to transactions with affiliates, extensions of credit to executive officers, and tying arrangements.</td>
</tr>
<tr>
<td>OCC</td>
<td>All functions relating to the supervision of federal savings associations.</td>
</tr>
<tr>
<td>FDIC</td>
<td>All functions relating to the supervision of state-chartered savings associations.</td>
</tr>
</tbody>
</table>

Starting on March 12, 2012, federal and state savings associations are required to file quarterly Call Reports (instead of Thrift Financial Reports), and savings and loan holding companies are required to file with the FRB the same quarterly financial reports that bank holding companies are required to file.

**B. New Penalties for Violating Qualified Thrift Lender (QTL) Test**

Savings associations are subject to the Qualified Thrift Lender (QTL) test, where qualified thrift investments (which are residential mortgages, mortgage-backed securities, credit card loans, and education loans) must constitute at least 65 percent of the savings association’s portfolio assets on a monthly average basis in nine out of every twelve months. Before the enactment of the DFA, a savings association that was unable to pass the QTL test would either become a bank or be subject to certain restrictions under Home Owners’ Loan Act § 10(m).

DFA § 624 amends Home Owners Loan Act § 10(m) so that the restrictions are now as follows: (i) no new activities are allowed, other

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75. DFA § 624.
76. See Home Owners Loan Act § 10 (12 U.S.C. § 1467a(m)(1)).
than those permissible for a national bank; (ii) branching activities are limited to those permissible for a national bank; (iii) dividends to the holding company are restricted to those permissible for a national bank that are “necessary to meet the obligations of a company that controls such savings association” and receive the prior approval of the OCC and the FRB; and (iv) the savings association can be subject to enforcement action under Federal Deposit Insurance Act § 8.

C. Dividends of Mutual Savings and Loan Holding Companies

DFA § 625 amends § 10(o) of the Home Owners’ Loan Act by requiring that each subsidiary of a mutual holding company that is a savings association must notify the appropriate federal banking agency of a proposed declaration of a dividend on the guaranty, permanent, or other nonwithdrawable stock of the savings association not later than thirty days before the date of such dividend. Any dividend declared without giving the required notice is invalid and confers no rights or benefits on the holder of any stock.

Importantly, a mutual holding company may waive the right to receive any dividend declared by a subsidiary of the mutual holding company if (i) no insider of the holding company, associate of an insider, or tax-qualified or non-tax-qualified employee stock benefit plan of the holding company holds any share of the stock in the class of stock to which the waiver would apply or (ii) the mutual holding company receives no objection from the FRB after it provides written notice to the FRB of its intent to waive the right to receive dividends. Such written notice must be provided no later than thirty days before the date of the proposed date of payment of the dividend. It must include a copy of the resolution of the board of directors of the mutual holding company, in the form and substance required by the FRB, together with any supporting materials relied on by the board of directors concluding that the proposed waiver is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company.

For the FRB not to object to the waiver, the mutual holding company must show that (i) the waiver would not be detrimental to the safe and sound operation of the savings association and (ii) the board of directors of the mutual holding company expressly determined that a waiver is consistent with the fiduciary duties of the board of directors.  

77 See 12 U.S.C. § 1467a(o).
### Summary of Pertinent Deadlines and Corresponding Events

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
</table>
| **January 21, 2012** | FRB and FSOC issue regulations relating to FRB-supervised BHCs.  
FRB issues regulations concerning stress testings. |
| **July 21, 2012** | FRB issues regulations with respect to covered transactions.  
Lending limit changes concerning credit exposure become effective.  
Lending limit changes concerning credit exposure to insiders become effective.  
Volcker Rule takes effect.  
FSOC reports to Congress on feasibility and benefits of a contingent capital requirement for nonbanks. |
| **September 2012** | OCC assesses single fee schedule for national banks and savings associations. |
| **July 21, 2013** | Three-year moratorium on industrial banks and credit card banks ends. |
I. Regulatory Relief
   - Interest on demand deposit accounts
   - *De novo* interstate branching

II. Deposit Insurance Reform
   - Increase in deposit insurance amounts
   - Changes to deposit insurance assessment structure

III. Safety and Soundness Restrictions
   - Countercyclical capital requirements
   - Bank lending limits changed to restrict credit exposure to derivatives (January 12, 2012)
   - Volcker Rule restricting proprietary trading (July 21, 2012)
   - Restrictions on charter changes for troubled institutions
   - FRB authorized to increase regulation of certain nonbank affiliates
   - Living wills for banks with over $50 billion in assets

IV. Merger and Acquisition Restrictions
   - Nationwide 10 percent concentration limits for acquisitions
   - BHCs and banks must be well capitalized and well managed for interstate bank acquisitions
   - FHC must be well capitalized and well managed to acquire financial subsidiaries
   - Three-year statutory moratorium on nonbank banks
V. Transaction and Activity Restrictions

- Limitations on preemption of state laws for national banks and federal savings associations
- Electronic debit card transactions
- Affiliate and insider transaction restrictions
- Funds availability
- Diversity practices assessments

VI. Abolition of OTS

- OTS functions transferred to FRB, OCC, and FDIC
- New penalties for a savings association violating the QTL test
- Dividends of mutual savings and loan holding companies