I am pleased to present the Spring 2010 issue of the Banking Law Committee Journal. You've done it again! Thanks to the contributions of Committee Members Pete Bergan, Satish Kini, Paul Lee, Tom Vartanian, Gordon Miller and Travis Nelson, this issue of the Journal is filled with up-to-date information and insightful commentary about recent developments of interest to banking lawyers.

Pete has prepared a great summary and pointed critique of the FDIC's ANPR on bank-sponsored securitizations. Satish's and Paul's article on the February report of the Senate Permanent Subcommittee on Investigations, detailing instances of access by politically exposed persons to the U.S. financial system, serves as an important reminder of regulatory concerns about PEPs that banks neglect at their peril. Tom and Gordon have provided a thorough and thoughtful comparison of bank receivership and bankruptcy regimes, questioning whether it makes sense to apply the receivership template to non-bank financial companies, as proposed in the House-approved Wall Street Reform and Consumer Protection Act. And Travis has explained the implications for federal chartered banks and thrifts of the closely-divided Supreme Court's corporate political spending decision in Citizens United v. Federal Election Commission.

Finally, last and, yes, least, we have the answer to last issue's Test Your Banking Knowledge question and the names of the four Committee Members who got it right, as well as a new question for your entertainment.

All Committee members are encouraged to contribute articles to the Journal. Analyses of recent developments are always welcome, but book reviews, opinion pieces or other submissions relevant to the banking business are also appropriate. You will be reaching a nationwide audience of more than 2000. Feel free to contact Peter Heyward at peheyward@venable.com or 202-344-4616 if you would like to propose an item for the next issue.

Sally Miller
Chair, Banking Law Committee
smiller@aba.com

Featured Articles

FDIC Issues ANPR on Its Role As Receiver or Conservator of Assets Transferred in Connection with a Bank-Sponsored Securitization
Peter C. Bergan

In mid-December, the Federal Deposit Insurance Commission (the "FDIC") released an Advance Notice of Proposed Rulemaking regarding Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After March 31, 2010 (the "ANPR"). 75 Fed. Reg. 934 (January 7, 2010) (to be codified at 12 C.F.R. pt. 360). The FDIC solicited public comment regarding possible amendments to the "safe harbor" rule for off-
balance sheet securitizations currently codified in 12 C.F.R. § 360.6. The ANPR seeks comment on a draft revised rule (the "Proposed Rule") that would permanent make the interim grandfathering of securitizations closed before March 31, 2010.

The Proposed Rule, however, goes beyond extending this safe harbor and ventures into other securitization issues, such as disclosure and risk retention requirements creating a potentially sweeping rule change in the area of bank-sponsored securitizations.

**More...**

### A Renewed Focus on Foreign Corruption and Access by Politically Exposed Persons to the U.S. Financial System

**Satish M. Kini and Paul L. Lee**

On February 4, 2010, the Senate Permanent Subcommittee on Investigations released a 325-page report detailing instances of access gained by politically exposed persons ("PEPs") to the U.S. financial system. The Subcommittee Report provides a cautionary tale for U.S. financial institutions and professionals, including lawyers, in dealing with PEPs. Through four case histories, the Report chronicles how PEPs were able to use U.S. lawyers, real estate agents and escrow agents to circumvent anti-money laundering ("AML") controls at U.S. financial institutions. It also highlights deficiencies in the AML procedures of these financial institutions. The Report concludes that U.S. financial institutions need to strengthen, and other intermediaries, including lawyers, realtors and escrow agents, need to adopt, PEP programs to prevent U.S. institutions from being used to conceal, protect and use gains from foreign corruption. The Subcommittee Report itself comes on the heels of a World Bank survey report issued in November 2009 that found a low level of compliance with internationally recommended measures directed at PEPs and political corruption.

**More...**

### Changing the Rules to Create Systemic Safety: Federal Receiverships for Nonbanks

**Thomas P. Vartanian and Gordon L. Miller**

Special rules to deal with bank insolvency pre-date the Great Depression and the Federal Deposit Insurance Act, enacted in 1933 (FDIA). In 1864, The National Bank Act authorized the Comptroller of the Currency, rather than a court, to appoint a receiver for national banks, and in 1873 shareholders of an impaired national bank were made liable for an assessment up to the par value of their stock. Bank insolvency measures were introduced in Congress as early as 1837 in response to banking panics. Thus, while FDIA and the Federal Deposit Insurance Corporation (FDIC), with the assistance of deposit insurance, have unquestionably succeeded in preventing bank runs, resolving failed banks and reducing the destabilizing effects of bank failures, the issue today is whether the bank receivership model is the best way to deal with nonbank financial companies
that pose systemic risk.

More...

Political Spending By Banks After Citizens United v. Federal Election Commission
Travis P. Nelson

"If the First Amendment has any force, it prohibits Congress from fining or jailing citizens, or associations of citizens, for simply engaging in political speech." – Justice Anthony Kennedy, Citizens United

I. Introduction The U.S. Supreme Court's January 21, 2010, 5-4 decision in Citizens United v. Federal Election Commission has sparked immediate debate at the highest levels of our Government as to the propriety of political spending by corporations. In his January 27, 2010 State of the Union Address, President Barack Obama said of the decision:

With all due deference to separation of powers, last week the Supreme Court reversed a century of law that I believe will open the floodgates for special interests – including foreign corporations – to spend without limit in our elections. I don't think American elections should be bankrolled by America's most powerful interests, or worse, by foreign entities. They should be decided by the American people. And I'd urge Democrats and Republicans to pass a bill that helps to correct some of these problems.

More...

Test Your Banking Knowledge

First, the answer to last issue's question: What do Alan Greenspan and the late Ernesto "Che" Guevara have in common? The answer is that each served as the head of his country's central bank. Of course, one can't push the comparison too far: Che's tenure was marred by his rigid adherence to an outdated ideology, and he served for less than two years (from November 1959 to February 1961). The Maestro's tenure lasted more than 18 years, from 1987 to 2006.

Congratulations to Committee members Pete Bergan, Scott Smith, Peggy Mevs and John Knoeckel for getting the right answer!

Here is the new question: Which real-world financial institution did director Francis Ford Coppola use for the exterior shot of the fictitious bank where New York's Five Families negotiated a truce to their long-running war in Godfather I?

The first five respondents with the correct answer will have their names published in the next issue. Good Luck!
FDIC Issues ANPR on Its Role as Receiver or Conservator of Assets Transferred in Connection with a Bank-Sponsored Securitization

by Peter C. Bergan*

Introduction

In mid-December, the Federal Deposit Insurance Commission (the “FDIC”) released an Advance Notice of Proposed Rulemaking regarding Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After March 31, 2010 (the “ANPR”). The ANPR requests comments on the standards that should be adopted to provide safe harbor treatment in connection with participations and securitizations issued after March 31, 2010 (the “Proposed Rule”).

The Proposed Rule, however, goes beyond extending this safe harbor and ventures into other securitization issues, such as disclosure and risk retention requirements creating a potentially sweeping rule change in the area of bank-sponsored securitizations.

Background

Typically, when a bank fails, the FDIC is appointed as a receiver or conservator for the purpose of administering that bank’s assets and liabilities. The FDIC, as receiver or conservator, has the power to repudiate any contract deemed “burdensome” if such repudiation would encourage the orderly administration of that bank’s assets. Such repudiation, though, could have potentially drastic effects on securitization contracts where the failed bank is the sponsor or at least where the bank has transferred financial assets in connection with a securitization. For instance, if a bank has transferred a number of financial assets into a special purpose vehicle to effectuate a subsequent securitization, theoretically, the FDIC would have the power to recover those assets in the event of the transferor bank’s failure.

Because of the uncertainty that the FDIC’s repudiation authority would otherwise cause concerning securitization contracts, in 2000 the FDIC adopted a legal isolation safe harbor (the “Securitization Rule”), codified at 12 CFR 360.6, providing that it would not use its repudiation authority to recover assets transferred in a securitization as long as such transfer constituted a sale under generally accepted accounted principles (“GAAP”). In order to achieve sale treatment under Financial Accounting Standard (“FAS”) 140, the transfer required: (i) that the assets be isolated from the transferor, beyond the reach of its creditors in either bankruptcy or receivership; (ii) that the transferee be able to pledge or exchange any interest it receives in the assets; and (iii) that the transferor not maintain control over the transferred assets. At the time

---

* Peter Bergan is an associate in the Bloomfield Hills, Michigan office of Plunkett Cooney in the firm’s Banking, Bankruptcy, and Creditors’ Rights practice group. The views and opinions in this article are entirely the author’s and not those of either Plunkett Cooney or any of its clients.


FAS 140 was issued back in 2000, the Financial Accounting Standards Board (“FASB”) was concerned that transfers meeting the requirement for sale treatment might nonetheless be reclaimed by the FDIC in the event the transferor bank failed. Therefore, the FDIC promulgated the Securitization Rule to address this concern by providing a safe harbor from certain aspects of the insolvency of the bank by confirming that in the event of a bank failure, the FDIC would not try to reclaim financial assets transferred into a securitization so long as an accounting sale under FAS 140 had occurred.

Last year, changes in accounting rules for securitizations called into question the effectiveness of the Securitization Rule. Modifications to GAAP through FAS 166 and 167 have made it significantly more difficult to achieve sale accounting treatment for transfers of assets in securitizations. Specifically, the change required that the underlying assets of some bank-sponsored securitizations be consolidated on the balance sheets of the sponsoring banks. In addition to raising questions about the treatment of existing transactions that are required to be brought on selling institutions’ balance sheets, this development has also raised questions about whether, and under what circumstances, on-balance sheet securitizations should be covered by the legal isolation safe harbor, considering that many such transactions require legal isolation certainty in order to obtain external ratings or to satisfy investors’ due diligence concerns.³

And so, in an effort to address many of the above concerns, November, 2009, the FDIC issued a transitional interim rule protecting existing securitizations complying with the Securitization Rule until March 31, 2010 at which time a new rule would be put in place.

The ANPR

The current interim rule grandfathers all securitizations issued prior to March 31, 2010 that otherwise comply with the old safe harbor rule, so long as those securitizations meet the requirements for sale treatment under GAAP prior to the effective date of the new Financial Accounting Statements 166 and 167 (January 1, 2010). The ANPR, however, also includes within the safe harbor on-balance sheet securitizations that were not historically covered by the Securitization Rule, and provides limited relief for creditors of insolvent insured depository institutions for which the FDIC has been appointed as receiver or conservator.

Furthermore, the ANPR considers issues related to the structure of securitization transactions that go far beyond the issues that would typically determine whether the conservator or receiver of an insolvent bank could recover assets previously sold to a securitization vehicle. As a result, an adoption of the Proposed Rule would cause sweeping changes in the area of bank-sponsored securitizations.

Along with a copy of the Proposed Rule, the ANPR poses thirty-five questions in five substantive areas: (i) capital structure; (ii) disclosures; (iii) documentation and recordkeeping; (iv) compensation; and (v) origination and retention requirements.

Disclosure Requirements

In an effort to promote sound originating and underwriting practices, one of the goals of the Proposed Rule is to increase transparency in securitizations.

The Proposed Rule would require the sponsoring back to disclose to the investors information describing the financial assets, obligations, capital structure, compensation structure, and historical performance. Such requirements would not vary whether or not the securitization is offered to the public or to institutional investors in a private placement.

The Proposed Rule also would also provide that while obligations are outstanding, information shall be made available on the performance of the obligations, including: (i) periodic and cumulative financial asset performance data; (ii) delinquency and modification data for the financial assets; (iii) substitutions and removal of financial assets; (iv) servicer advances; (v) any losses allocated to a particular tranche and the remaining balance of financial assets supporting that tranche; and (vi) the percentage of each tranche in relation to the securitization as a whole.4

Documentation Requirements

The documents must define the rights and responsibilities of the various parties, including representations and warranties, ongoing disclosure requirements, and measures to avoid conflicts of interest. The contractual rights and responsibilities of each party to the transaction must provide authority for the various parties to fulfill their respective roles, while clearly distinguishing between any multiple roles performed by any party.5

The sponsoring institution must maintain records of its securitizations separate from its other operations; with such records being made available for review by the FDIC promptly upon written request.6

Compensation Restrictions

The compensation rules within the Proposed Rule would only apply to securitizations in which the financial assets include residential mortgage loans. The Proposed Rule would require that compensation be structured to provide incentives for sustainable credit and the long-term performance of the financial assets and securitization. Any fees paid to a party would need to be payable over the five-year period following the issuance, with no more than 80% of the total estimated compensation due to any party at closing. Moreover, compensation should provide incentives for servicing and loss mitigation actions that maximize the value of the financial assets.7

5 Id.
6 Id.
7 75 Fed. Reg. 941.
Origination and Retention Requirements

The ANPR recognizes the simple fact that if a sponsoring bank were required to retain an economic interest in the assets transferred such bank would be more concerned with the quality of the assets utilized in the origination. The Proposed Rule would require a sponsor to retain an interest in a “material portion” of the credit risk; defined at 5% or more of the credit risk of the financial assets. This retained interest may be in the form of an interest in each of the credit tranches of the securitization or in a representative sample of the transferred assets equal to at least 5% of the principal amount of the assets at the time of transfer. Under the Proposed Rule, this retained interest may not be transferred or hedged during the term of the securitization.8

Once the new capital requirements are fully phased in, FDIC insured institutions will be required to sustain risk-based capital against securitization assets that are now on-balance sheet as if those assets had not been securitized at all. Thus, those institutions are being required to maintain risk-based capital as if there had been no risk transfer through securitization on the basis that they have retained too much risk. At the same time, under the Proposed Rule, those same institutions would be required to retain not less than 5% of the credit risk of the transferred assets to assure a sufficient exposure to risk to encourage improved underwriting of loans.9

The Proposed Rule further provides that to qualify for the safe harbor, transactions would need to be at arm’s length, with no obligations being sold to an affiliate or an insider. The securitization agreements would need to be in writing, approved by the bank’s board or loan committee. Furthermore, the securitization would need to be entered into in the ordinary course of business, not in contemplation of insolvency and with no intent, delay, or defraud the bank or its creditors.

Rules Applicable to Residential Mortgage Backed Securities

Recognizing that the securitization of residential mortgages played a role in the recent financial crisis, the ANPR provides specific rules for residential mortgage backed securities throughout the substantive areas discussed above.

For instance, the Proposed Rule would require that no more than six credit tranches exist and that all residential mortgage loans transferred into the securitization be seasoned loans that were originated not less than twelve months prior to such transfer. Servicing and other agreements would need to provide servicers with full authority to mitigate losses on financial assets consistent with maximizing the net present value of the financial asset. The Proposed Rule states that documents must require the servicer to act for the benefit of all investors, and not for the benefit of any particular class of investors. The servicer, under the Proposed Rule, would have the authority to take any actions necessary to maximize the value and minimize losses on the securitized financial assets.10

---

8 Id.
One troubling requirement in the Proposed Rule is that for securitizations in which the financial assets include residential mortgage loans, “all assets shall have been originated in compliance with all statutory, regulatory and originator underwriting standards in effect at the time of origination.” Sponsoring institutions and other participants are likely to look to the lawyers for the sponsor to provide a legal opinion as to whether the requirements of the rule have been satisfied. Most lawyers and law firms would not be willing to issue such a legal opinion where the portfolio is overly complex and/or contained assets across multiple jurisdictions.\textsuperscript{11}

**Analysis**

The FDIC’s ANPR brings up a number of issues, many of which are thoroughly discussed among the thirty-five comments submitted by various financial institutions, trade organizations, law firms, and others. Stated simply, the ANPR goes far above and beyond merely extending the Securitization Rule; rather, it imposes a variety of substantive and administrative requirements on securitizations of assets transferred from banking institutions.

An initial concern is the potential clash between the FDIC’s primary role as an insurer of bank deposits and its role in policing securitization markets.\textsuperscript{12} As a deposit insurer the FDIC is concerned with banks acquiring interests in various securitizations where the risks of such interests are complex and not readily understandable.\textsuperscript{13} However, because most securities issued in bank securitizations are not “bank securities” they are subject to the SEC’s regulatory jurisdiction.\textsuperscript{14} The FDIC playing the role of a securities regulator may create confusion and may ultimately encroach on the SEC’s jurisdiction. As such, the Proposed Rule imposes a number of relatively sweeping changes for bank-sponsored securitizations; many of those changes, however, would be more appropriate from the SEC, or even Congress.

The main focus of the Proposed Rule is securitizations that are originated by the transfer of assets from a bank. The Proposed Rule, however, does not address securitizations that ultimately make their way onto the balance sheets of those same banks. And so, at best, the Proposed Rule has the potential to regulate only a fraction of securitizations into which banks may invest. Imposing more rigid securitization requirements on banks than on other securitizing entities could seriously impede banks’ sources of liquidity.\textsuperscript{15}

The Proposed Rule muddles the priority of who or what the FDIC is designed to protect. The Proposed Rule makes it clear that the FDIC is concerned, at least in part, with protecting investors of bank-sponsored securitizations in that the rule requires enhanced documentation and

\textsuperscript{11} ASF, *supra* note 9, at page 17.

\textsuperscript{12} K&L Gates, *supra* note 3, at page 5.

\textsuperscript{13} Id.


\textsuperscript{15} See K&L Gates, *supra* note 3, at page 5.
disclosure requirements, among other things. Although, even if the FDIC is concerned with protecting investors in bank-sponsored securitizations, the Proposed Rule takes a very unusual approach to achieving that objective because it places investors without an adequate remedy in the event of a bank failure or violation of the Proposed Rule. The FDIC could potentially seek to recharacterize a securitization transaction as a secured borrowing and choose not to waive its consent right under the Securitization Rule. This action, though, would do little to help investors. This would do very little to reprimand a violating institution, and only result in further losses to the investors of the securitization. This result is entirely inapposite to the primary goal of the isolation safe harbor noted in the ANPR, namely, “that investors could look to securitized financial assets for payment without concern that the financial assets would be interfered with by the FDIC as conservator or receiver.”

Moreover, the Proposed Rule creates significant questions for ratings agencies that evaluate securitization. The benefit sought by the ratings industry is the ability to separate the rating of the underlying assets from the rating of the originator or sponsoring institution. In a properly structured transaction, regardless of the rating of the obligor, the senior most securitization obligations should be given the highest rating by any number of the rating agencies. With the FDIC’s Proposed Rule, however, rating agencies would be concerned with the FDIC’s ability to repudiate a securitization agreement, forcing the agencies to look to both the underlying assets as well as the sponsoring institution.

For an effective safe harbor a new securitization rule should have clearly defined conditions that can be assessed by all of the participants in the transaction; and, if met at the time of the issuance of the relevant securities, should provide benefits that continue over the life of the securities. The Proposed Rule conflates proper securitization procedures with the necessity for an effective legal isolation safe harbor. A separation, however, is necessary in order to provide sufficient comfort to investors who look to the financial assets of the securitization rather than the originating institution when weighing the risks involved with such an investment.

Conclusion

With the recent accounting changes, it is understandable that the Securitization Rule from 2000 would need to be revisited. And with the recent economic crisis, in-part linked to bank-sponsored securitizations, it seems prudent that the FDIC would like to revisit the Securitization Rule before going forward.

The Proposed Rule, however, attempts to accomplish much more than simply extending the old legal isolation safe harbor rule beyond March 31, 2010. The Proposed Rule substantially alters the regulation of bank-originated securitizations to the detriment of investors and banks alike. The rule restricts the ability of a bank to tap into securitization markets by making the

16 *Id.*

securitization requirements cumbersome, and ultimately inefficient. The Proposed Rule should be primarily concerned with reducing the risk to investors where a bank sponsoring a securitization happens to become insolvent. To the extent that the FDIC is moving beyond this goal in its Proposed Rule, it is overstepping its bounds; regulating in an area that is more properly left for another administrative organization, namely, the SEC.
A RENEWED FOCUS ON FOREIGN CORRUPTION AND ACCESS BY POLITICALLY EXPOSED PERSONS TO THE U.S. FINANCIAL SYSTEM

By Satish M. Kini and Paul L. Lee∗

Background

On February 4, 2010, the Senate Permanent Subcommittee on Investigations released a 325-page report detailing instances of access gained by politically exposed persons (“PEPs”) to the U.S. financial system. The Subcommittee Report provides a cautionary tale for U.S. financial institutions and professionals, including lawyers, in dealing with PEPs. Through four case histories, the Report chronicles how PEPs were able to use U.S. lawyers, real estate agents and escrow agents to circumvent anti-money laundering (“AML”) controls at U.S. financial institutions. It also highlights deficiencies in the AML procedures of these financial institutions. The Report concludes that U.S. financial institutions need to strengthen, and other intermediaries, including lawyers, realtors and escrow agents, need to adopt, PEP programs to prevent U.S. institutions from being used to conceal, protect and use gains from foreign corruption. The Subcommittee Report itself comes on the heels of a World Bank survey report issued in November 2009 that found a low level of compliance with internationally recommended measures directed at PEPs and political corruption.

The Subcommittee Report, of course, has no immediate legislative or regulatory effect, but it deserves attention from financial institutions and other service providers, such as lawyers. For more than a decade, the Subcommittee has investigated money laundering issues at U.S. financial services firms and has publicized what the Subcommittee has viewed as deficiencies in U.S. efforts to combat money laundering and foreign corruption. These past reports have resulted in regulatory focus on the issues highlighted by the Subcommittee. In addition, the Subcommittee’s Chair, Carl Levin (D-MI), was a principal author of many of the AML provisions that were included in the USA Patriot Act; the genesis of those provisions was the Subcommittee’s work. Two of the AML provisions in the Patriot Act directly dealt with foreign corruption. One provision added bribery of a public official or misappropriation of public funds by a public official to the list of predicate offenses for a federal criminal money laundering charge. The other provision mandated “enhanced scrutiny” by U.S. financial institutions of accounts managed by or on behalf of a senior foreign political figure or an immediate family member or close associate of such a figure. The findings of the Subcommittee

∗ Paul Lee and Satish Kini are Partners and Co-Chairs of the Banking Group of Debevoise & Plimpton, LLP, working in the New York and Washington, D.C. office, respectively. The views expressed in this article are the authors' and do not necessarily reflect those of Debevoise & Plimpton or the firm's clients.
Report suggest that the existing AML and PEP measures may need to be strengthened and extended to other service intermediaries.

Key Findings of the Subcommittee Report.

Using four detailed case studies, the Subcommittee Report examines the ways in which PEPs from Equatorial Guinea, Gabon, Angola and Nigeria gained extensive access to the U.S. financial system and used that access to acquire significant U.S. real estate and other assets and to do business with U.S. and international firms. The Report finds that these PEPs used U.S. and offshore shell companies as well as U.S. lawyers, real estate agents and escrow agents (who are currently exempt from AML requirements under the Patriot Act) to mask suspicious transactions and to circumvent U.S. financial institutions’ AML controls. According to the Report, the use of these intermediaries by the PEPs was highly effective. The PEPs studied were able to engage in high-dollar volume transactions through U.S. banks for many years without detection.

According to the Subcommittee, the AML efforts of the U.S. banks involved in the four cases studies were also uneven. Examples of the issues cited by the Subcommittee Report include the following:

- several of the banks had insufficient AML risk-rating systems, as a result of which they opened high-risk accounts which they lacked the capability to monitor adequately;

- other banks obtained insufficient information and performed inadequate diligence on account signatories and beneficial owners, which led them to fail to understand the PEP exposure presented by the accounts they were opening;

- other banks closed specific PEP accounts when they spotted suspicious transactions but failed to ascertain that those PEPs had interests in other accounts, which remained open and continued to be used for large-dollar transactions from foreign sources; and

- other banks detected suspicious transactions, such as large foreign wire transfers, but were slow to investigate and take remedial actions, as a result of which significant funds continued to flow through the banks during the interregnum.

The Subcommittee Report focuses on the intermediaries – including insurance agents, real estate agents, escrow agents and lawyers – who dealt with or represented PEPs. The Report is especially critical of a number of lawyers, whom the Subcommittee found were deliberate and purposeful in attempting to circumvent banks’ AML controls. The attorneys incorporated shell companies for the PEPs and used their law firm accounts to engage in transactions for PEPs. In these cases, when a bank detected suspicious transactions and closed one or more PEP accounts, the lawyer for a PEP helped the PEP
move funds to other accounts at the same or another bank. In one case, an attorney for a PEP also used his friendship with an insurance agent to circumvent an insurer’s policies and to obtain an extension of coverage for the PEP’s fleet of 32 motorcycles and cars. The findings of the Subcommittee Report provide further support for an observation in the World Bank report that corrupt PEPs are increasingly using lesser known associates or more complex corporate and trust arrangements to veil their identity. The World Bank report cites the increased use by PEPs of company formation agents, accountants, financial advisors and lawyers as complicating the task of identifying beneficial ownership.

Key Recommendations of the Subcommittee Report

Based on its findings, the Subcommittee Report makes several recommendations. First, the Report calls for enactment of federal legislation requiring persons forming U.S. corporations to disclose the beneficial owners of the corporations. Second, the Report calls for regulatory action by the Treasury to (i) repeal the existing exemptions from the Patriot Act requirement for AML programs, including the exemptions for real estate and escrow agents and sellers of vehicles such as aircraft and (ii) to issue an additional AML rule requiring U.S. financial institutions to obtain a certification for each attorney-client trust account and law office account that it will not be used to circumvent AML or PEP controls. Third, the Report calls upon professional organizations, such as the American Bar Association, the National Association of Realtors, and the American League of Lobbyists, to issue guidance to their members prohibiting the use of accounts to conceal PEP activities. Fourth, the Report calls for legislative and regulatory action to implement the recommendations from the World Bank report on PEPs. The World Bank report recommends various steps to strengthen PEP controls, including a recommendation that a financial institution request a public official to provide a copy of any asset and income declaration form filed with his or her home country authorities. The World Bank report notes that while more than 110 countries require their public officials to file asset and income declaration forms, only one bank in its survey asked its public official customers for a copy of the form.

Compliance Efforts and Lessons

The Subcommittee Report recognizes that U.S. financial institutions have become more vigilant in implementing AML and PEP programs. This by the way is in contrast to the World Bank report, which cites an “overall failure of effective implementation of international PEP standards” and a surprisingly low level of compliance with Financial Action Task Force (“FATF”) requirements on PEPs even among FATF members. The findings in the World Bank report confirm that there are many weak links in the global compliance chain.

The principal thrust of the Subcommittee Report is to expose the tactics being used by PEPs to circumvent or elude the AML and PEP controls at U.S. financial institutions. Nonetheless, as noted above, the Subcommittee Report does cite instances
of weakness in the controls of some U.S. institutions. None of the types of weakness identified will come as a surprise to those who are familiar with standard AML procedures. The Report found examples of inadequate screening of potential PEP clients by banks, the use of routine bank accounts not subject to enhanced monitoring, and weakness in wire transfer controls. These findings are a reminder to financial institutions that they need to review their account opening procedures to ensure that they receive adequate information about account signatories and beneficiaries and to confirm that they have appropriate account monitoring and transaction detection procedures and resources to spot and, in a timely manner, follow up on suspicious foreign wires and other higher-risk transactions. Firms that rely on third-party vendors for PEP detection may wish to confirm how reliable and comprehensive such software is in screening for PEPs. All such databases are likely to have some gaps, given the difficulties in defining PEPs. Firms should understand the limits of the databases they use and not rely on them exclusively for PEP detection.

Conclusion

The Subcommittee Report is likely to bring a renewed focus by U.S. regulators on PEP controls at U.S. financial institutions. Indeed, the first indication of that renewed focus came on March 5, 2010 when the Financial Crimes Enforcement Network and the federal financial institution regulators issued consolidated guidance on the regulatory expectations for financial institutions to obtain beneficial ownership information for customer accounts, including senior foreign political figures. This guidance largely codifies existing regulatory and supervisory expectations, but its issuance confirms the importance that the regulators attach to this area. If any additional incentive need be provided for financial institutions to review their PEP controls, it should come in the form of a recent comment by a Justice Department official that a new strategy emerging from recent Foreign Corrupt Practices Act cases will be action against PEPs from corrupt regimes who seek to bring their money into the United States. **Caveat** financial institution!
CHANGING THE RULES TO CREATE SYSTEMIC SAFETY:
FEDERAL RECEIVERSHIPS FOR NONBANKS

By Thomas P. Vartanian and Gordon L. Miller*

Special rules to deal with bank insolvency pre-date the Great Depression and the Federal Deposit Insurance Act, enacted in 1933 (FDIA). In 1864, The National Bank Act authorized the Comptroller of the Currency, rather than a court, to appoint a receiver for national banks, and in 1873 shareholders of an impaired national bank were made liable for an assessment up to the par value of their stock.1 Bank insolvency measures were introduced in Congress as early as 1837 in response to banking panics.2 Thus, while FDIA and the Federal Deposit Insurance Corporation (FDIC), with the assistance of deposit insurance, have unquestionably succeeded in preventing bank runs, resolving failed banks and reducing the destabilizing effects of bank failures, the issue today is whether the bank receivership model is the best way to deal with nonbank financial companies that pose systemic risk.

Under the Wall Street Reform and Consumer Protection Act (Reform Act) approved by the U.S. House of Representatives,3 the FDIA receivership model would be extended to a wide range of nonbank financial companies, including bank holding companies, insurance companies and securities brokers or dealers (Covered Financial Companies), that could be placed in special receiverships (CFC Receiverships).4 It is necessary, however, to look critically at how the CFC

---


2 See Peter P. Swire, Bank Insolvency Law Now that It Matters Again, 42 Duke L.J. 469, 478 (1992) [hereinafter Swire].

3 H.R. 4173, 111th Cong.

4 The Reform Act would establish a Financial Services Oversight Council that, in addition to its other responsibilities, would consult with the Federal Reserve Board (FRB) and other specified regulators in order to identify companies to which to apply stricter prudential standards based on the threat they pose to financial stability or the economy. Reform Act § 1103(a). In addition to these systemically significant companies, all bank holding companies under the Bank Holding Company Act (12 U.S.C. § 1841 et seq.) (BHCA), all companies predominantly engaged in activities permissible for a financial holding company under BHCA, all insurance companies and all subsidiaries of the foregoing (other than a subsidiary that is an insured bank or is a broker or dealer that is registered with the Securities and Exchange Commission (SEC) and is a member of the Securities Investor Protection Corporation) would be “financial companies.” Reform Act § 1602(9). Any financial company could be designated
Receivership rules under the Reform Act would be applied to Covered Financial Companies to understand what the proposed reforms can reasonably be expected to accomplish. While the Reform Act would give much more authority and flexibility to federal regulators to deal with non-depository institutions whose financial condition threatens to destabilize the financial system, it also would inject a significant element of uncertainty and foster an *ad hoc* decision-making process that could adversely affect companies that may at some point be subject to a special receivership regime, as well as their equity holders, creditors and counterparties.

**Why Banks and Bank Receiverships Are Special**

FDIA reflects the nature of the problem it was designed to solve—the failure of banks and the losses suffered by their depositors, which constitute their largest class of creditors. Historically, bank failures have been viewed as posing special problems for several reasons:

- Deposits in banks constitute a large proportion of the liquid assets of the American public;
- Bank deposits constitute the largest share of the country’s money supply and are its primary medium of exchange;
- Banks are major providers of credit to individuals, businesses and government;
- Banks play a central role in the payments system;
- A large portion of the deposit and non-deposit liabilities of banks are short-term, which makes banks susceptible to the effects of a run;
- Bank assets, generally extensions of credit, may be harder to value than the assets of other businesses, which makes it more difficult to judge a bank’s condition; and
- Banks are closely interconnected as counter-parties to one another, which increases the contagious effects of a bank’s illiquidity or insolvency.5

---

FDIA addresses these issues directly and indirectly. Deposit insurance protects the claims of the general public, and the FDIC provides depositors with immediate access to the insured amount, and frequently the full amount, of their deposits. This has significantly reduced public anxiety about bank failures, largely eliminated depositor runs, made the money supply more stable and allowed banks to attract funds and maintain liquidity at lower costs. These effects in turn have helped banks to lend at lower interest rates and avoid credit contractions generated by the necessity to maintain liquidity in the face of depositor runs and have reduced the contagious spread of fear of bank defaults.6

The design of FDIA also has had consequences for the FDIC. The FDIC acts as receiver of a failed bank (responsible for liquidating a failed bank’s assets) and as its principal creditor (based on its subrogation to the claims of the depositors it pays off or arranges for another bank to assume).7 As a result of simultaneously filling both of these roles, the FDIC sits on and dominates both sides of the table when resolving a failed bank. Consequently, issues that arise in the course of a receivership may come to be viewed by the agency and the Congress as management issues rather than questions of competing rights and duties.8 For example, the FDIC’s handling of claims has been streamlined to an extent that might not be tolerated if non-FDIC claimants were the largest creditors.9 On the other hand, FDIA also enables the FDIC to address systemic supervisory concerns that may not be the particular concern of any individual

---

6 This discussion is not intended to be an exhaustive description of the effects of deposit insurance. Other institutional arrangements and business developments, such as asset securitization, the availability of the FRB discount window and the increased use of non-cash and non-check payment methods, have affected the ability of banks to respond to liquidity needs and the public’s reliance on banks.

7 See 12 U.S.C. §§ 1821(f)(1) (payment or transfer of insured deposits) and 1821(g)(1) (subrogation to all rights of depositor against failed bank). For example, 45 banks and savings associations failed during the fourth quarter of 2009. Total deposits paid out or assumed equaled 82% of total liabilities and shareholders’ equity, and the median percentage for all receiverships was 91%. Source: Failed Bank List, available at http://www.fdic.gov/bank/individual/failed/banklist.html.

8 Swire, 42 Duke L.J. at 481-482, 520-529, describes how the FDIC, as a result of playing all the roles in a bank receivership that are split among the creditors, trustee and bankruptcy judge in a bankruptcy case, and having the additional obligation to protect the Deposit Insurance Fund (DIF), tends to push the costs of bank resolution off-budget and onto third parties. Bliss and Kaufman, 2 Va. L. & Bus. Rev. at 165, suggest that the combination of the FDIA depositor preference rule, the FDIC’s subrogation to depositors’ priority and the FDIC’s obligation to minimize losses for the DIF (but not for general creditors) may unintentionally provide the FDIC with the incentive to use unsecured general creditors’ claims as a capital cushion.

9 Compare, inter alia, 12 U.S.C. §§ 1821(d)(5)(E) (judicial review of claims against a receivership), 1821(e)(1) and (2) (right of the FDIC to repudiate contracts) and 1823(e) (enforceability of agreements that tend to diminish or defeat the interest of the FDIC) with the corresponding Bankruptcy Code provisions, discussed infra.
creditor, such as reducing the cost of receiverships by identifying and closing failing banks before they are technically insolvent and by enforcing cross-guarantee liability.10

Another consequence of the FDIC’s control of receiverships is less procedural transparency than is provided to claimants in bankruptcy proceedings, which take place in open court.11 The FDIC has engaged in relatively little rulemaking and issued limited public guidance regarding its receivership procedures.12

These observations are not intended to suggest that the receivership system for banks under FDIA has not worked well, but to point out that it embodies a particular set of public policy issues and institutional arrangements. However, while the FDIA receivership model has been promoted as the most practical alternative for resolving Covered Financial Companies,13 relatively little attention has been paid to how the bank receivership model might actually operate when applied to them. A CFC Receivership would in fact be likely to be significantly different from a failed bank receivership for several reasons, not the least of which is that Covered Financial Companies are not depository institutions: They hold different types of assets and the effects of their failure would be borne largely by a diverse group of non-deposit creditors. Dealing with the investors, creditors and customers of a Covered Financial Company under the FDIA receivership model would introduce considerable uncertainty into its resolution.

---


11 See, e.g., 11 U.S.C. § 501 (providing for all proofs of claims or interests to be filed as public records) and § 502 (permitting any party in interest to object to any proof of claim or interest). FDIA and FDIC bank receivership procedures do not provide an easily accessible mechanism for a party to review other claims or participate in the determination whether to allow them.

12 See 12 C.F.R. § 359.7 and 12 C.F.R. Part 360. There are no regulations regarding the filing of claims, the principles for determining whether to allow claims or the operation of the FDIC’s repudiation authority, nor has the FDIC adopted administrative procedures for the review of disallowed claims. Limited additional guidance is provided by policy statements and advisory opinions. See, e.g., Covered Bond Policy Statement, 73 Fed. Reg. 21949 (April 23, 2008) [hereinafter Covered Bond Policy Statement]. Advisory opinions are available at http://www.fdic.gov/regulations/laws/rules/4000-50.html.

Comparison between Bankruptcy and CFC Receivership

The uncertainty of dealing with a company that may possibly be placed into receivership based on the FDIA model would begin with determining whether the company was in fact likely to be treated in this manner in the present or the future and would continue as one considered the numerous differences between bankruptcy and receivership in the rights of claimants. The uncertainty would extend to all aspects of the claims process.

Initiation of a CFC Receivership. As discussed above, the group of companies potentially subject to being placed into a CFC Receivership would include far more than the systemically significant companies identified by regulators. While the Reform Act includes the limitation that there is a “strong presumption” that a CFC Receivership “will only be used in the most exigent circumstances,”14 the uncertainty whether a company may be placed into receivership would affect more than those companies that may be readily identifiable as significant and troubled. Parties engaged in transactions with marginally significant companies and large but healthy companies also would need to consider how a change in such a company’s status or financial condition might affect their rights or remedies.

The process for placing a company in a CFC Receivership also would be difficult to monitor. It would mirror the process that must be followed in order for the FDIC to set aside the least-cost resolution test when providing open bank assistance.15 Not less than two-thirds of all members then serving on the Board of Governors of the FRB and on the board of the FDIC16 would be required to agree to recommend in writing to the Secretary (Secretary) of the Department of the Treasury (Treasury) that the FDIC be appointed as Receiver. The Secretary, in consultation with the President, would be required to determine that the company is in default or in danger of default, that its failure or dissolution outside Receivership would have serious

---

14 Reform Act § 1601(b).
16 If a company in question is a broker or dealer registered with the SEC or is an affiliate of such broker or dealer, or if it is an insurance company or an affiliate of an insurance company, the recommendation is made not by the FDIC but by not less than two-thirds of the members then serving on, respectively, the SEC or the state insurance authority for the state in which the company is domiciled. Reform Act § 1602(1)(A).
adverse economic or financial effects on the U.S. and that such receivership would be effective
to mitigate such effects in light of all relevant circumstances.\textsuperscript{17} This process would tend to
increase the uncertainty whether a company was about to be placed in a CFC Receivership.
Moreover, the uncertainty would remain even after a company entered into bankruptcy. A
company could be designated thereafter as a Covered Financial Company, in which event the
bankruptcy case would be terminated.\textsuperscript{18}

\textbf{Substantive Effects on Claimants’ Rights.} The differences in the treatment of claims
between bankruptcy and a CFC Receivership would be pervasive and frequently detrimental to
claimants against a Covered Financial Company.

\textit{Automatic Stay.} In bankruptcy, an automatic stay takes effect when a bankruptcy petition
is filed and generally remains in effect until the conclusion of the case, unless it is earlier lifted
or modified by the bankruptcy court upon notice and hearing.\textsuperscript{19} The automatic stay prevents,
among other things, the commencement or continuation of an action against the debtor on pre-
bankruptcy claims, any enforcement or collection action against the debtor or property of the
estate in bankruptcy, the establishment or perfection of a lien against property of the estate and
the exercise of most setoff rights.\textsuperscript{20} In a CFC Receivership, for 90 days beginning on the date the
Receiver was appointed, no person, without the consent of the Receiver, may exercise any right
or power to terminate, accelerate or declare a default under any contract to which the Covered
Financial Company was a party, to affect any contractual rights of the company or to obtain
possession of or exercise control over any property of the company.\textsuperscript{21} The Receiver also could

\textsuperscript{17} Reform Act § 1603(a) and (b).

\textsuperscript{18} Reform Act § 1607(a).

\textsuperscript{19} 11 U.S.C. § 362(a)-(f). A secured creditor may request the bankruptcy court upon notice and hearing to
grant relief from the stay for cause, including the lack of adequate protection or the wasting of its collateral. 11 U.S.C. §§ 362(d) and 363(e).

\textsuperscript{20} 11 U.S.C. § 362(a). Special provisions applicable to qualified financial contracts and certain other
contracts are not addressed here. \textit{See} 11 U.S.C. §§ 555-557 and 559-562; Reform Act § 1609(c)(4)-(11) and (13).

\textsuperscript{21} Reform Act § 1609(c)(13)(C)(i). This provision would prohibit a creditor from exercising its contractual
rights as a secured creditor over any property of the Covered Financial Company pledged as collateral. However,
creditors with a perfected security interest in assets of a Covered Financial Company would be able to seek an
expedited review of their claims by the Receiver if the creditors alleged that irreparable injury would occur if they
were required to follow the routine claims procedures. Reform Act § 1609(a)(6)(A).
request a stay for up to 90 days in any noncriminal judicial action, and no attachment or execution could be issued by a court against any assets of a Covered Financial Company that were in the Receiver’s possession.22

**Ipso Facto Clause.** While *ipso facto* clauses are not generally enforceable in bankruptcy, there is an exception for certain *executory contracts* when applicable law excuses a counterparty to the debtor from accepting performance from or rendering performance to the trustee or an assignee (such as under a personal services contract) and the counterparty does not consent, or when the contract is for the provision of credit or financial accommodations to or for the benefit of the debtor or is for the issuance of securities of the debtor.23 The Receiver, however, would have broader powers. In general, it could enforce *any contract* entered into by a financial company notwithstanding any provision allowing termination, default, acceleration or exercise of remedies upon, or solely by reason of, insolvency, the appointment of a receiver or the exercise by a receiver of its rights or powers, and, without the Receiver’s consent, no person may exercise any such right against a Covered Financial Company or the property of a Covered Financial Company for 90 days after the Receiver is appointed.24

**Claims Determination.** Once claims were filed, further differences would emerge. In bankruptcy, a decision to disallow a claim is made by a bankruptcy court upon notice and hearing, and a party in interest may ask the bankruptcy court to reconsider its decision and may appeal the bankruptcy court’s decision to the district court.25 In a CFC Receivership, determinations would be less transparent. Claims would initially be filed with and ruled on by the Receiver. Its decision would not be subject to rehearing or appeal, but a claimant that was dissatisfied with the Receiver’s determination could file a *de novo* suit on the identical claim (or

---

22 Reform Act § 1609(a)(9) and (10)(C).
23 11 U.S.C. § 365(e). While there is no definition of “executory” in the Bankruptcy Code, the majority of bankruptcy courts follow the view than an executory contract is one under which the obligations of both the debtor and the party are so far unperformed that the failure of either party to complete its performance would constitute a material breach, excusing the other party’s performance. See Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973).
24 Reform Act § 1609(c)(13)(A) and (C).
continue an action that was commenced before the Receiver was appointed but was stayed) in an applicable U.S. district court.\textsuperscript{26}

\textit{Repudiation or Rejection.} A trustee in bankruptcy may reject executory contracts or certain unexpired leases with the approval of the bankruptcy court upon notice and hearing.\textsuperscript{27} In contrast, the Receiver could disaffirm or repudiate any contract to which a Covered Financial Company was a party, without prior notice, within a “reasonable period” after the Receiver was appointed if performance of the contract would be “burdensome” and the disaffirmation or repudiation would promote the orderly administration of the CFC Receivership.\textsuperscript{28}

\textit{Damages.} In bankruptcy, if a trustee rejects an executory contract or unexpired lease, any claim arising from the rejection is treated as a prepetition claim for any resulting damages.\textsuperscript{29} In a CFC Receivership, damages for repudiation of a contract would be limited to “actual direct compensatory damages” determined as of the date the receiver was appointed, which would exclude punitive or exemplary damages or consequential damages for lost profits.\textsuperscript{30}

\textit{Haircut on Certain Fully Secured Claims.} In the event that (i) the Treasury or the Systemic Dissolution Fund (Fund) were owed any amounts that were not paid in full from the proceeds of the dissolution of a Covered Financial Company, and (ii) funds also were unavailable to satisfy any claims of the unsecured creditors and shareholders of the company, then the Receiver could seek to recover the amounts owed to the Treasury and the Fund by treating up to 10 percent of the allowed and legally enforceable or perfected claims of creditors

\textsuperscript{26} Reform Act § 1609(a)(4)(A) and (E), (a)(5)(A) and (a)(10)(D).

\textsuperscript{27} 11 U.S.C. § 365(a). In a Chapter 7 liquidation case, if the trustee takes no action with regard to an executory contract or an expired lease of residential real property or of personal property within 60 days after the order for relief in the case was issued, the contract or lease is deemed to be rejected (unless the court, for cause, extends this deadline). 11 U.S.C. § 365(d)(1). In a Chapter 11 reorganization case, the trustee, with the approval of the court, may reject an executory contract at any time before a plan of reorganization is confirmed (unless the court sets a prior deadline). 11 U.S.C. § 365(d)(2).

\textsuperscript{28} Reform Act §1609(c)(1) and (2).


\textsuperscript{30} Reform Act § 1609(c)(3)(A) and (B).
(other than the U.S.) under any qualified financial contracts with an original term of 30 days or less as unsecured claims. The Bankruptcy Code has no comparable provision.

Agreement to Diminish or Defeat Interest. A claim filed in bankruptcy is subject to generally applicable rules of contractual interpretation. In a CFC Receivership, special restrictions apply. A modification of a contract or other agreement that would diminish or defeat the interest of the Receiver in any asset of the CFC Receivership would be unenforceable against the Receiver unless it was in writing and had been executed by an authorized officer or representative of the Covered Financial Company.

 Preferential Transfers. In order to avoid a preferential transfer in bankruptcy, a trustee must satisfy certain specific requirements. The Receiver would be required to satisfy the same requirements.

 Fraudulent Transfers. Under the Bankruptcy Code, a trustee may avoid a transfer of an interest in property of, or an obligation incurred by, the debtor in bankruptcy within two years of the filing of the bankruptcy petition with the actual intent to hinder, delay or defraud any person to whom the debtor is or becomes indebted. The Bankruptcy Code also permits a trustee to avoid such transfer or obligation without establishing fraudulent intent if the debtor in

---

31 Reform Act § 1609(a)(4)(D)(iv) and (v). This provision would not apply to qualified financial contracts secured by securities issued by the Treasury, the FRB, the Federal Reserve Banks, any U.S. agency or any government sponsored enterprise or to debt obligations secured by real property. The Receiver would be authorized to utilize the Fund to facilitate the dissolution of a Covered Financial Company and to borrow from the Treasury for certain purposes. Reform Act § 1604(n)(2)(C) and (o)(1).

32 Reform Act § 1609(a)(7). These requirements are less exacting than the comparable provisions in FDIA and under common law. See 12 U.S.C. § 1823(e); Statement of Policy Regarding Federal Common Law and Statutory Provisions Protecting FDIC, as Receiver or Corporate Liquidator, Against Unrecorded Agreements or Arrangements of a Depository Institution Prior to Receivership, 62 Fed. Reg. 5984 (Feb. 10, 1997).

33 The transfer must have been (i) to or for the benefit of a creditor, (ii) for or on account of an antecedent debt, (iii) made while the debtor was insolvent and (iv) made within 90 days before the filing of the petition in bankruptcy (or within one year if the creditor was an insider of the debtor at the time the transfer was made) and it must enable the creditor generally to receive more than it would have received in a Chapter 7 liquidation case, assuming the preferential transfer had not been made. 11 U.S.C. § 547(b).

34 Reform Act § 1609(a)(12)(B). See also Reform Act § 1609(a)(12)(F) and (G) (incorporating defenses and limitations from the Bankruptcy Code).

35 11 U.S.C. § 548(a)(1)(A). A trustee also may rely on state fraudulent conveyance laws, which often permit a trustee to challenge much older transfers or obligations. 11 U.S.C. § 544(d).
bankruptcy received less than reasonably equivalent value in exchange and was either insolvent at the time or as a result of the transaction, lacked adequate capital for its line of business, intended to incur or believed that it would incur debts that it would be unable to pay as they matured or made such transfer under an employment contract with an insider not entered into in the ordinary course of business. The authority of the Receiver to attack such transactions would be quite different. It would be able to avoid a transfer of any interest in property of an institution affiliated party of a Covered Financial Company or of a debtor of a Covered Financial Company, or avoid any obligation incurred by such persons, within five years of the Receiver’s appointment if the transfer was made or the liability was incurred with the intent to hinder, delay or defraud the Covered Financial Company or the Receiver. The Receiver also would be able to avoid a legally enforceable or perfected security interest in an asset of the company if it determined that the security interest was taken “in contemplation of the company’s insolvency or with the intent to hinder, delay or defraud the company or the creditors of such company.”

Priorities. Even after a claim has been allowed, it would be treated differently in bankruptcy than in a CFC Receivership. In bankruptcy, a claim secured by a lien on property of an estate in bankruptcy is secured up to the value of the creditor’s interest in such property, and it is an unsecured claim to the extent that the value of such interest in such property is less than the allowed claim. In a Chapter 7 liquidation case, the property of the debtor’s estate available for distribution to unsecured creditors is distributed to creditors following a detailed order of priority provided by the Bankruptcy Code and pro rata among the creditors in each class. In a Chapter 11 reorganization case, all claims and interests must be properly classified and, if impaired under a plan of reorganization, are given the opportunity to vote on the plan. If a class of claims votes to reject a plan, it still may be confirmed by the bankruptcy court if it satisfies the

36 11 U.S.C. § 548(a)(1)(B). If the debtor is a partnership, certain additional transactions with a general partner also may be avoided. 11 U.S.C. § 548(b).
37 Reform Act § 1609(a)(12)(A). A transfer by a Covered Financial Company itself or the assumption of an obligation by the Covered Financial Company would not be covered by this provision.
38 Reform Act § 1609(c)(12)(A).
“cramdown” requirements and adheres to the absolute priority rule.\textsuperscript{42} In a CFC Receivership, rules similar to those in a Chapter 7 liquidation case would apply.\textsuperscript{43} Holders of unsecured claims would not be entitled to recover more than they would be entitled to receive in a Chapter 7 liquidation case.\textsuperscript{44} However, the general rule that all unsecured claims that have the same priority must be treated similarly would be subject to a significant exception that does not exist in bankruptcy: The Receiver would be able to prefer one creditor or a group of creditors that were part of a larger class if the Receiver determined that the preference was necessary to maximize the value of the assets of the Covered Financial Company, to maximize the present value or minimize the loss realized upon the sale or disposition of such assets or to address systemic economic or financial concerns.\textsuperscript{45} In addition, if the Receiver was otherwise unable to obtain financing for a Covered Financial Company from commercial sources, it could grant an unsecured creditor a super-priority ahead of all administrative expenses and behind only secured creditors.\textsuperscript{46}

\textbf{Limitations of CFC Receivership}

The uncertainty engendered by the differences between bankruptcy and CFC Receivership rules would be compounded by limitations on the Receiver’s authority. Some of these limitations could be cured relatively easily, but others would affect any special receivership regime and bring into question one of the premises of such a regime.

\textbf{Bridge Authority.} The Receiver would have the authority to organize a bridge financial company (BFC) to acquire the assets and assume the liabilities of a Covered Financial Company.\textsuperscript{47} Under FDIA, the FDIC may organize a bridge bank when it determines that the

\textsuperscript{42} 11 U.S.C. § 1129(a) and (b).
\textsuperscript{43} Reform Act § 1609(b)(4) and (5).
\textsuperscript{44} Reform Act § 1609(d)(2).
\textsuperscript{45} Reform Act § 1609(b)(4)(A). The other claimants in the larger class would remain entitled to receive no less than they would have received in a Chapter 7 liquidation case. Reform Act § 1609(b)(4)(B).
\textsuperscript{46} Reform Act § 1609(b)(2). In bankruptcy, a trustee may grant a similar priority bit only by showing upon notice and hearing that financing without such priority is not available. 11 U.S.C. § 364(c) and (d).
\textsuperscript{47} Reform Act § 1609(a)(1)(E) and (h)(1).
continued operation of a failed bank is essential to provide adequate banking services to the community it serves or is in the best interest of its depositors. The FDIC has used this power sparingly, but, based on the nature of the situations in which the FDIC has used the authority, the Receiver may use its authority more regularly under the Reform Act. Under FDIA, the FDIC has organized a bridge bank to help stabilize the market served by a failed bank and to obtain additional time and flexibility to market a failed bank that could not be readily resolved because of its size or complexity. In a CFC Receivership, the size and complexity of a Covered Financial Company and the feared consequences of its failure, together with the limited opportunity that the Receiver would likely have in the midst of a financial crisis to prepare for the failure of a specific Covered Financial Company, suggest that the FDIC, notwithstanding its expertise in resolving failed banks, would frequently find it useful to organize one or more BFCs to help it maintain the status quo while it considered and developed alternatives for a Covered Financial Company’s resolution.

If the Receiver elected to use its BFC authority, it would find certain infirmities in the BFC charter. The Reform Act does not state explicitly what form a BFC may take. However, it authorizes a BFC to follow the practices and procedures “applicable to a corporation incorporated under the general corporation law of the State of Delaware” or the state of a financial company’s incorporation or organization. The reference to Delaware corporate law suggests that a BFC must be a corporation. This restriction could have consequences if a

---

48 12 U.S.C. § 1821(n)(1) and (2).


50 Reform Act § 1609(h)(2)(F). Elsewhere in the Reform Act, a “bridge financial company” is defined by reference to a “financial company,” which is defined by reference to a “bank holding company” under BHCA. Reform Act § 1602(2) and (9). A bank holding company is not restricted by BHCA to the form of a corporation. However, the more specific provision regarding a BFC’s corporate governance would appear to impose an additional set of limitations.
Covered Financial Company or a significant subsidiary of a Covered Financial Company was a limited partnership or limited liability company or was chartered outside the U.S., since a change in charter or the domestication of a company could complicate a Covered Financial Company’s resolution. It also appears that the FDIC in its corporate capacity would issue the corporate charter for a BFC, although the FDIC has no specific authority to issue charters and no experience doing so.\footnote{A bridge bank is chartered by the OCC and is operated and regulated as a national bank. 12 U.S.C. § 1821(n)(1)(A).} Finally, since a BFC would be defined by reference to a “bank holding company” under BHCA, it would be subject to the limitations found in the BHCA definition of that term. Under BHCA, the definition of a bank holding company excludes “any corporation the majority of the shares of which are owned by the U.S. or by any State.”\footnote{12 U.S.C. § 1841(a)(1) and (b).} This restriction might prevent the Receiver from chartering a BFC that would issue capital stock that the Receiver would hold.\footnote{A BFC would not be required to issue capital stock, but this may not always be possible. Reform Act § 1609(h)(2)(G).} These ambiguities in the BFC charter may hamper the Receiver’s ability to take decisive action.

**Restricted Jurisdiction.** A CFC Receivership would resemble a receivership for a failed bank in its limited ability to provide a comprehensive resolution for certain complex or internationally active organizations. Under the Reform Act, several entities would be expressly exempted from designation as a Covered Financial Company. An insured depository institution that was a subsidiary of a Covered Financial Company, provided that it was not deemed to be systemically significant, regardless of its size or its significance within its parent organization, would continue to be resolved separately under FDIA.\footnote{Reform Act § 1602(9)(A)(v).} A broker or dealer that was a subsidiary of a Covered Financial Company also would be resolved separately, unless it was specifically designated as systemically significant.\footnote{Id. Futures commission merchants and commodity pool operators are not excluded.} Any insurance company covered by an insolvency provision under state law, and any insurance company that was a subsidiary of such insurance company, would be exempt.\footnote{Reform Act § 1604(e)(1) and (2). Insurance companies also are covered by an exemption under the Bankruptcy Code. 11 U.S.C. § 109(b)(2).} Larger financial organizations tend to be internationally active.
and to have subsidiaries organized outside their home country, and a large proportion of Covered Financial Companies would presumably share this feature. These companies would remain subject to “ring-fencing” of their assets by each jurisdiction in which they operated, as regulators sought to freeze assets in place in order to make them available to satisfy local creditors. Therefore, it is not clear how a CFC Receivership would contribute to the more rapid, efficient or comprehensive resolution of a complex or internationally active organization.

CFC Receivership in a Political Environment

The uncertainty and limitations of a CFC Receivership also should be considered in the context in which a CFC Receivership would be most likely to be imposed. The task of resolving a Covered Financial Company would appear to be, almost by definition, an anomalous event for which there would be little useful precedent. In addition, the receivership methods discussed above (i) have never been applied to nonbanks, in which the principal claimants would be secured creditors and general unsecured creditors (rather than a fairly uniform set of depositors represented by the FDIC) and the principal assets would be likely to include something other than extensions of credit with a maturity measured in years, (ii) are generally harsher than the methods applied in bankruptcy and (iii) would test the planning, expertise and resources of the Receiver in ways for which the FDIC could hardly be expected to prepare. Resolving a Covered Financial Company during a financial crisis would only add to the uncertainty. This combination of circumstances would raise questions regarding how well or how quickly a CFC

---


58 For example, the FDIC makes territorial claims when a foreign bank with an insured branch in the U.S. fails, but it asserts a claim to assets worldwide when a U.S. bank with foreign branches fails, while FDIA depositor preference rules primarily benefit insured U.S. depositors. Compare 12 C.F.R. § 347.209 (requiring a foreign bank with an insured branch in the U.S. to pledge assets for the benefit of the FDIC) with 12 U.S.C. § 1821(d)(2)(A) (providing for the FDIC to succeed to all interests of a failed insured depository institution in the assets of the institution) and 12 C.F.R. § 330.3(e) (providing that an obligation of an insured depository institution payable solely outside the U.S. is not treated as a deposit). See also FDIC Press Release PR-201-2009, “East West Bank, Pasadena, California Assumes All the Deposits of United Commercial Bank, San Francisco, California” (Nov. 6, 2009) (describing resolution of Hong Kong and Shanghai, China branches).
Receivership would be able to resolve a Covered Financial Company and how the interests of multiple claimants and other counterparties would be handled.

Furthermore, if the Receiver sought to pursue anything other than a rapid and straightforward liquidation of a Covered Financial Company, the Treasury and, to a lesser extent, the Congress would become involved. Notwithstanding statements to the contrary by members of the Congress and the Administration, some form of extended resolution would appear to be the rule rather than the exception. The Receiver would be called upon, to the greatest extent practicable, to maximize the net present value realized from the sale or disposition of a Covered Financial Company’s assets, to minimize the loss realized from the resolution of a Covered Financial Company, to minimize the cost to the Treasury and to prevent or mitigate serious systemic risks to the U.S. financial system and economy.69 Pursuing these goals might require the Receiver to stabilize a Covered Financial Company rather than summarily to liquidate it, and in order to do so the Receiver could extend credit, guarantee or issue obligations, acquire a lien, purchase assets or transfer acquired assets for this purpose.60 As noted above, the Receiver also could prefer certain claimants over others for this purpose and make additional payments to them, provided that no member of the same class of claimants received less than it would receive in a Chapter 7 liquidation case.61 However, any decision by the Receiver to extend or support an extension of credit, engage in an asset transaction or make an additional payment to a claimant would require the Secretary’s approval.62 It would appear that any plan to make additional payments to certain claimants while ensuring that all similarly situated claimants receive no less than they would receive in liquidation would require such borrowing.63 Stated more concisely,

69 Reform Act § 1609(a)(10)(E).
60 Reform Act § 1604(d). These are not unusual measures. The FDIC has frequently used them to help minimize the loss realized from the resolution of failed banks. For example, the FDIC entered into a structured transaction in order to maximize its recovery from the assets of Corus Bank, N.A., Chicago, Illinois, in which it acquired a 60% equity interest in the purchasing entity, extended credit to the entity, provided a guarantee (in its corporate capacity) of notes issued by the entity and acquired a lien on the assets purchased to secure its guarantee. FDIC Press Release PR-183-2009, “Corus Bank Assets – Winning Bidder Announced” (Oct. 6, 2009).
61 Reform Act § 1609(b)(4), (d)(2) and (d)(3)(A).
62 Reform Act §§ 1604(d) and 1609(d)(3)(A). If the Fund was insufficient for this purpose, and the Receiver decided to borrow from the Treasury as part of a plan of resolution, the Secretary also would be required to consult with the appropriate committees of the Congress. Reform Act § 1609(o)(1)(A) and (7).
63 To borrow more than $150 billion would require specific congressional approval. Reform Act § 1609(o)(4) and (s).
to reduce costs and protect the U.S. financial system and economy, the Receiver, with the approval of the Secretary, may stabilize a Covered Financial Company, including by extending credit, and pay off claimants when it is deemed expedient to do so for the purpose. 64

It is difficult to see how such a task would differ from the situation that the FRB and the Treasury faced in 2008 regarding Fannie Mae, Freddie Mac, AIG or Citigroup. 65 It also would appear, in view of the indicated uncertainty regarding how a CFC Receivership may affect claimants and how effective a plan of extended resolution may be and the requirement that the Treasury approve any plan including a preference or requiring governmental assistance, that the Treasury would assume a major role, if not the leading role, in deciding how to resolve most Covered Financial Companies. Under these circumstances, the FDIC would operate not as an independent authority, as it does in a bank receivership, but as an arm of the Treasury. 66

Conclusion

The unintended consequences of CFC Receiverships based on the FDIA receivership model should be carefully evaluated and understood. While CFC Receiverships would not be expressly intended to be used to provide stability during economic crises, they would provide the means to government to do so and to protect certain favored creditors, customers or shareholders. The government may be able to use such power wisely, but overly aggressive governmental action could influence how capital markets behave in periods of relative calm and plant the seeds of future crises. Moral hazard could be created precisely when the intent is to eliminate it. 67

64 The establishment of a BFC also may involve many of the stabilizing actions described above. See Reform Act § 1609(h)(5). Therefore, it is not clear whether the Secretary also must approve the establishment of any BFC.

65 See, e.g., Treasury Press Release TG-67, “Treasury Secretary Tim Geithner Written Testimony House Financial Services Committee Hearing” (Mar. 24, 2009); Treasury Press Release HP-1279, “Testimony by Treasury Secretary Henry M. Paulson, Jr. before the House Committee on Financial Services” (Nov. 18, 2008); and Treasury Press Release HP-1080, “Testimony by Secretary Henry M. Paulson, Jr. on GSE Initiatives before the Senate Banking Committee” (July 15, 2008).

66 When dealing with a Covered Financial Company facing default, the FDIC might not receive the deference that it would receive with regard to the resolution of a failed bank and, as a consequence, may not have the corresponding ability to “push back” against a plan of resolution proposed by the Secretary with which it disagreed.

67 See Peter J. Wallison, Why Financial Reform Is Stalled, Wall St. J. (Mar. 1, 2010) at A25. The expectation that a Covered Financial Company in financial distress would be placed into a receivership in which management
and investors would be “punished” may make it more difficult for management to attract investors and avoid failure than it would be if bankruptcy was the company’s only alternative. Incurring excessive debt instead of raising capital may further discourage subsequent investors because any cash flow generated by their investment would primarily enhance the recovery by debtholders. Ultimately, management and potential investors may become engaged in a “game of chicken” with the government. See Kenneth Ayotte and David A. Skeel, Jr., *Bankruptcy or Bailouts?*, Institute for Law & Economics of the University of Pennsylvania Law School Research Paper No. 09-11 (2009), available at [http://ssrn.com/abstract=1362639](http://ssrn.com/abstract=1362639).
POLITICAL SPENDING BY BANKS AFTER CITIZENS UNITED V. FEDERAL ELECTION COMMISSION

By Travis P. Nelson
Pepper Hamilton LLP

“If the First Amendment has any force, it prohibits Congress from fining or jailing citizens, or associations of citizens, for simply engaging in political speech.”
– Justice Anthony Kennedy, Citizens United

I. Introduction

The U.S. Supreme Court’s January 21, 2010, 5-4 decision in Citizens United v. Federal Election Commission has sparked immediate debate at the highest levels of our Government as to the propriety of political spending by corporations. In his January 27, 2010 State of the Union Address, President Barack Obama said of the decision:

With all due deference to separation of powers, last week the Supreme Court reversed a century of law that I believe will open the floodgates for special interests – including foreign corporations – to spend without limit in our elections. I don’t think American elections should be bankrolled by America’s most powerful interests, or worse, by foreign entities. They should be decided by the American people. And I’d urge Democrats and Republicans to pass a bill that helps to correct some of these problems.

President Obama’s unusual decision to criticize a Supreme Court whose justices were sitting mere feet from his podium was reciprocated by Justice Samuel Alito, who could be

1 Travis P. Nelson (nelsont@pepperlaw.com) is an attorney with Pepper Hamilton LLP, in the firm’s Washington, DC and Philadelphia, PA offices. Mr. Nelson formerly worked in the Enforcement Division of the Office of the Comptroller of the Currency (“OCC”), is a former member of the Maryland State Banking Board, and serves as the current president of the OCC Alumni Association (www.occalumni.com). The author regularly represents financial institutions and other companies in transactional, regulatory, enforcement, and litigation matters.

seen mouthing the words “not true” from his seat in the first two rows of the House chamber. In response to President Obama’s remarks, Bradley A Smith, a former GOP-appointed chairman of the Federal Election Commission (“FEC”) and long-time opponent of restrictions on corporate political spending, said of the likely Democrat response: “The First Amendment should not be plowed over because of an inconvenient political storm. This is a cynical attempt to brush aside constitutional concerns because of a short-term perception of partisan gain.”

The Court in *Citizens United* addressed the ability of corporations to participate in political speech through funding advertisements on public issues. The Court held that the First Amendment prohibits government regulation of political speech by businesses and as such the government may not ban political spending by corporations in candidate elections. While the facts of the *Citizens United* decision involved non-bank corporations generally, it also applies to political spending by banks and labor unions. In fact, the federal statute at issue in *Citizens United* explicitly refers to “national banks” as well as corporations.

This article examines the political and legislative history that led to the federal statute under the Court’s review in *Citizens United*, the scope of the Court’s holding, and what new regulation national banks may now expect, if any.

---

3 Press Release, “Citizens United proposals a cynical attempt to corrode First Amendment,” Center for Competitive Politics (February 11, 2010).

II. Discussion

(a) Legislative Background and Statutory Scheme

The current panoply of legislation and regulations restricting the scope of political spending traces its roots to post Civil War America, where concentration of wealth resulting from industrial expansion following the post-war boom in the industrial North led to abuses prompting a tide of reform protest in the late 19th Century. For example, the federal Sherman Antitrust Act\(^5\) was in enacted in order to preserve and promote economic freedom in the new industrial era, and prevent the aggregation of power in the hands of a few. Further, in the 1890s, many states passed laws requiring candidates and their political committees to make public the sources and amounts of their contributions, and the amounts of their expenditures.

Additional substantive reform came from trust-buster President Theodore Roosevelt. In his December 5, 1905, message to Congress, President Roosevelt recommended as the first item of congressional business that all campaign contributions by corporations be forbidden by law.\(^6\) In 1907, Congress provided that it was unlawful for any national bank, or any corporation organized by authority of any laws of Congress, to make a monetary contribution in connection with an election to any political office, and unlawful for any corporation whatsoever to make a monetary contribution in connection with any election at which presidential and vice-presidential electors or a congressional representative or United States senator were to be voted upon.\(^7\) The 1910 Congress enacted a publicity law requiring that committees operating in two or more states to influence congressional elections disclose contributions and disbursements,


\(^{6}\) 1-14 Banking Law § 14.03.

\(^{7}\) Id.
identifying the source or recipient of any substantial sums. In 1918, Congress made it unlawful to offer or solicit any thing of value to influence voting.\textsuperscript{8}

The criminal prohibition on certain political spending activities was expanded in 1948 under Section 610 of the Federal Criminal Code, which controlled corporation and labor organization election contributions and expenditures. This provision essentially prohibited national banks, corporations, and labor organizations from making contributions or expenditures in connection with federal elections.\textsuperscript{9} This provision was replaced and reenacted by the Federal Election Campaign Act of 1971.\textsuperscript{10} This act was later amended in 1976.

One provision remaining after the 1976 amendments was the statute at issue in \textit{Citizens United}. This statute reads:

\begin{verbatim}
§ 441b. Contributions or expenditures by national banks, corporations, or labor organizations

(a) In general

It is unlawful for any national bank, or any corporation organized by authority of any law of Congress, to make a contribution or expenditure in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office, or for any corporation whatever, or any labor organization, to make a contribution or expenditure in connection with any election at which presidential and vice presidential electors or a
\end{verbatim}


Senator or Representative in, or a Delegate or Resident Commissioner to, Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices, or for any candidate, political committee, or other person knowingly to accept or receive any contribution prohibited by this section, or any officer or any director of any corporation or any national bank or any officer of any labor organization to consent to any contribution or expenditure by the corporation, national bank, or labor organization, as the case may be, prohibited by this section.11

Under this provision, national banks are not permitted to make contributions or expenditures in connection with federal elections, but may establish a separate political fund to maintain a political action committee ("PAC").12 Additionally, while national banks could not make contributions to a PAC directly,13 they could solicit contributions from their employees to their PAC.14

The most comprehensive guidance on political activities by banks currently offered by a federal bank regulator is OCC Bulletin 2007-31 (August 24, 2007). This guidance confirms that national banks are subject to the Federal Election Campaign Act of 1971, as amended, and specifically to 2 U.S.C. § 441b. The OCC guidance further states that national

---

11 While on its face the statute refers to national banks and not federal savings associations, because federally-chartered savings and loan associations become corporations upon receiving a charter from the Office of Thrift Supervision, the statute is also applicable to such savings associations. See, Federal Election Commission ("FEC") Advisory Opinion ("AO") 1981-33 (Sept. 21, 1981).


13 FEC AO 1980-54 (June 17, 1980); FEC AO 1979-17 (July 16, 1979).

banks are prohibited from making any contribution or expenditure or providing any service (except usual and customary banking services) or any thing of value in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office. The OCC guidance further provides that national banks are not prohibited from engaging in: (a) communications with their stockholders and executive or administrative personnel; (b) nonpartisan registration and get-out-the-vote campaigns aimed at their stockholders and executive or administrative personnel and their families; and (c) the establishment, administration, and voluntary solicitation of contributions to a PAC.  

While the statute vests exclusive civil enforcement jurisdiction in the FEC, the OCC reserves for itself the ability to bring an appropriate administrative enforcement action to seek compliance with the statute.

\[(b)\]  The Citizens United Decision

At issue in *Citizens United* was the constitutionality of 2 U.S.C. § 441b, as amended by § 203 of the Bipartisan Campaign Reform Act of 2002 (“BCRA”). Section 441b is a federal law that prohibits corporations, unions, and federally-chartered banks from using their general treasury funds to make independent expenditures for speech that is an “electioneering communication” or for speech that expressly advocates the election or defeat of a candidate.

In January 2008, appellant Citizens United, a nonprofit corporation, released a documentary (“Hillary”), which was critical of then-Senator Hillary Clinton, a candidate for the Democrat Party’s Presidential nomination. Anticipating that it would make *Hillary* available on cable television through video-on-demand services within 30 days of primary elections, Citizens


\[16\]  Id.
United produced television ads to run on broadcast and cable television. Concerned about possible civil and criminal penalties for violating § 441b, it sought declaratory and injunctive relief, arguing, among other things, that § 441b is unconstitutional as applied to Hillary. The District Court denied Citizens United a preliminary injunction and granted appellee FEC summary judgment.

The U.S. Supreme Court granted certiorari and reversed. In arriving at the Court’s holding, Justice Kennedy, joined by Chief Justice Roberts and Justices Scalia, Alito and Thomas, undertook a lengthy and detailed analysis of Supreme Court precedent on restrictions on political speech. Justice Kennedy was careful to distinguish prior precedent when he deemed it necessary, but the majority overruled a significant precedent - *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990) - that they determined was no longer sound. In the end, the Court held that the restrictions on political spending contained in § 441b target protected speech, and therefore such restrictions are facially unconstitutional. According to the Court: “[T]he Government may not suppress political speech on the basis of the speaker’s corporate identity. No sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations.” Because the government, through the FEC, could not articulate a compelling governmental interest sufficient enough to trump First Amendment liberties, the Court determined that § 441b did not pass constitutional muster.

Writing for the dissenters, Justice John Paul Stevens, joined by Justices Sotomayor, Breyer, and Ginsburg, voiced the concern that allowing unfettered spending by

---

17 Justice Kennedy’s decisive role in this case underscores his key role as a “swing” vote on this ideologically polarized Court. As one astute observer of the Court has observed to the author: “It’s Kennedy’s world. The rest of us just live in it.”

wealthy corporations will allow them to influence the outcome of elections in sweeping ways. Justice Stevens emphasized that corporations “are not human beings” and that “corporations have no consciences, no beliefs, no feelings, no thoughts, no desires. Corporations help structure and facilitate the activities of human beings, to be sure, and their ‘personhood’ often serves as a useful legal fiction. But they are not themselves members of ‘We the People’ by whom and for whom our Constitution was established.”

Through its discussion of the constitutionality of § 441b as applied to corporations generally, and the Court’s affirmation of prior precedent, the Court confirmed that its holding is not limited to attempts under federal law to restrict political speech by corporate speakers. The Court expressly stated: “We return to the principle established in . . . [First National Bank of Boston v. Bellotti].” In Bellotti, two national banks challenged a Massachusetts state law restricting the ability of banks and corporations to engage in political speech. The Citizens United Court, in affirming the continued validity of Bellotti, reiterated Bellotti’s “central principle: that the First Amendment does not allow political speech restrictions based on a speaker’s corporate identity.” Therefore, state law restrictions that purport to restrict corporate political speech based merely on the corporation’s identity are also unconstitutional.

(c) Future Restrictions on National Banks’ Political Spending.

In the wake of Citizens United, the universe of national banks’ political spending has changed. The definitive OCC guidance on political activities by national banks, OCC Bulletin 2007-31, was based entirely upon the assumed validity of the spending restrictions

---


contained in 2 U.S.C. § 441b. With the Court’s action in *Citizens United* of striking down such restrictions, however, the OCC appears to be without a basis under § 441b to restrict the political activities of national banks.

The federal bank regulatory agencies are no doubt actively considering how their chartered institutions are to proceed in light of *Citizens United*, however what regulatory options they may have are unclear. One major challenge that the agencies will encounter is that in the Court’s decisions in *Citizens United* and *Bellotti*, where it has clearly held that corporate political speech is considered to be largely on par with individual political speech, and where the Court has struck down federal and state law restrictions on the ability of banks to engage in protected political speech, is that the agencies must address the reality that the Court has implicitly recognized that engaging in political speech through political spending is a permissible power of banks, regardless of whether it fits within the traditional notion of what constitutes the “business of banking.” Moreover, while federal bank regulatory agencies, including the OCC, are granted broad, sweeping, and comprehensive rulemaking powers, it is axiomatic of administrative rulemaking that a federal agency’s power to regulate cannot exceed Congress’s power to legislate. Therefore, if the First Amendment prohibits Congress from creating rules that provide a general ban on national banks’ political spending, then the First Amendment would also prohibit such rules created by a federal regulatory agency, no matter how much deference they are typically and rightfully accorded.

While regulators may not be able to restrict banks’ political spending through rulemaking, it is conceivable that the same can be accomplished through contract. One proposal that has recently surfaced, proposed by Sen. Charles Schumer (D-NY), and Rep. Chris Van

---

Hollen (D-MD), is to ban political spending by those that receive funds through the Troubled Assets Relief Program (“TARP”). However, with the eagerness with which financial institutions have strived to escape the chains of TARP, attempting to overcome *Citizens United* through TARP restrictions will likely achieve only symbolic successes.

III. Conclusion

With the Supreme Court’s ruling in *Citizens United*, it would appear that a bank may spend unlimited sums on advertising or other forms of communication that expressly advocate for or against the election of a candidate, or other political issues, provided that the corporate spending is not in “coordination” with any particular candidate, his or her campaign, or a political party committee. In other words, (though over-simplifying) such political spending must be independent of the efforts of any particular candidate or campaign.23 These expenditures may be made either directly, by paying for the ad itself, or indirectly, by contributing to a trade association or outside advocacy group.

While the Court appears to have substantially loosened the restrictions on political spending by banks by permitting them to engage in direct funding of issue ads as well as ads supporting or criticizing a particular candidate, it remains to be seen whether banks will in fact take advantage of this newly affirmed freedom. In many instances, banks may want to take advantage of the lesser profile that operating through a PAC or a trade association might provide. Additionally, banks may achieve greater strength in numbers through collective lobbying than is unavailable when acting alone. Finally, many banks may want to avoid the publicity that supporting or opposing a particular candidate or cause might bring.

---

23 For example, a corporation may fund an advertisement supporting Obama for America, but it may not work with the Obama campaign’s staff to coordinate efforts or manage the message.
In the event that a bank does seek to engage in political spending directly, it must ensure compliance with the myriad of federal and state lobbying efforts, which in view of the *Citizens United* decision, will likely place a greater emphasis on “coordination” investigations, where the FEC, and its state counterparts, conduct investigations to determine whether a corporation illegally coordinated with a candidate or party. “Coordination” occurs when an individual or entity engages in political spending in cooperation, consultation, in concert with, or at the request or suggestion of, a candidate, the candidate’s campaign, the candidate’s agents or a political party committee or its agents.24 In policing for possible coordination violations, the FEC will consider: (1) whether the communication was paid for, in whole or in part, by someone other than a candidate, a candidate’s authorized committee, a political party committee or an agent of the above; (2) whether the content relates to the subject matter and timing of the communication; and (3) whether there are interactions between the person paying for the communication and the candidate, authorized committee or political party committee, or their agents.25

Finally, the OCC and other regulatory agencies are currently reviewing the *Citizens United* decision, and are considering whether additional guidance is necessary.

---


25  Though it is beyond the scope of this article, we note that there is some debate as to the continuing viability of “coordination” violations being applied to corporations. The theory would be that assuming natural persons are not subject to coordination violations, and corporations are now on par with natural person, then the First Amendment would also prohibit restrictions on coordination with campaigns.