Message from the Chair

The attached Fall edition of the Banking Law Committee Journal features outstanding contributions by Peter Bergan, Lori Buerger and Travis Nelson. Peter's article provides a thoughtful analysis of the Bankruptcy Court's recent rejection of the FDIC's claim against The Colonial Bancgroup for capital support commitments allegedly made before Colonial's bank subsidiary was placed in receivership in 2009. Lori has given us a savvy and useful account of recent changes in the FDIC's loss-share arrangements with bidders for failed banks. And Travis carefully explains the actual impact of Dodd-Frank on preemption of state laws, which is not as sweeping as some less insightful commentators would have it.

Travis also deserves congratulations as the one Committee member who provided the correct answer to our last Test Your Banking Knowledge! 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 answer, of course, is the Federal Reserve Bank of New York.

Thanks, as always, to Peter Heyward for doing a superb job providing editorial direction. Please consider submitting an article for the Spring edition of the Journal which will be published in early April, shortly before we meet in Boston. Peter's e-mail is peter.heyward@morganstanley.com.

I look forward to seeing many of you at our Fall meeting in two short weeks.

Sally Miller
Chair, Banking Law Committee
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Featured Articles

FDIC Takes a Hit: The Regulator's 365(o) Claim in Colonial Bancgroup’s Bankruptcy Fails
Peter C. Bergan

In a September 1, 2010 opinion, Judge Dwight H. Williams, Jr., of the U.S. Bankruptcy Court of the Middle District of Alabama, rejected the FDIC's claim that it is owed more than $900 million from Colonial Bancgroup in the former bank holding company's chapter 11 bankruptcy. Colonial Bank's failure in 2009 was, along with that of IndyMac, one of the largest that year. In the months preceding its closure, Colonial Bank's former parent had entered into a variety of formal and informal agreements with several banking regulators stating that it would "assist" Colonial Bank in achieving or maintaining certain capital requirements. The Court held, however, that none of the agreements constituted binding commitments to Colonial Bank's primary federal regulator under §365(o) of the Bankruptcy Code. As a result, FDIC's claim for priority was denied, entitling the FDIC to receive only a pro rata distribution with the other general unsecured creditors. The FDIC filed an appeal on September 13, 2010.
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FDIC-Assisted Acquisitions: Seizing Strategic Opportunities In the Midst of the "New Normal"
Lorraine M. Buerger

With each passing week, the roster of failed banks continues to grow. In the first three quarters of 2010, more than 125 financial institutions failed, putting the year on-pace to exceed 2009's 140 failures. Since the beginning of the financial crisis in 2007, more than 300 banks have been placed into FDIC receivership, with assets exceeding $634 billion.

The relentless pattern of weekly bank failures is echoed in the increasing number of institutions on the FDIC's list of problem institutions (more than 800 as of the most recent FDIC Quarterly Banking Profile). The size of that inventory of severely distressed institutions means that the "new normal," in which every Friday brings the failure of least one financial institution, is likely to continue into the foreseeable future.

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Preemption Under Title X of the Dodd-Frank Act
Travis P. Nelson

On July 21, 2010, President Obama signed into law what is considered by most to be the most sweeping financial services legislation since the Great Depression. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or the "Act") effects a variety of reforms to a broad cross-section of the financial services industry. Included within this legislative behemoth is the Consumer Financial Protection Act of 2010, codified at Title X of the Dodd-Frank Act. One of the most hotly contested issues of Title X, and of the entire Dodd-Frank Act for that matter, is the scope of federal preemption of state consumer financial laws, and the role of states in enforcing compliance by federally-chartered institutions with consumer financial laws. This article examines the changed standards and role of preemption under the Act.

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FDIC TAKES A HIT: THE REGULATOR’S 365(o) CLAIM IN COLONIAL BANCGROUP’S BANKRUPTCY FAILS

By Peter C. Bergan
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In a September 1, 2010 opinion, Judge Dwight H. Williams, Jr., of the U.S. Bankruptcy Court of the Middle District of Alabama, rejected the FDIC’s claim that it is owed more than $900 million from Colonial Bancgroup in the former bank holding company’s chapter 11 bankruptcy. Colonial Bank’s failure in 2009 was, along with that of IndyMac, one of the largest that year. In the months preceding its closure, Colonial Bank’s former parent had entered into a variety of formal and informal agreements with several banking regulators stating that it would “assist” Colonial Bank in achieving or maintaining certain capital requirements. The Court held, however, that none of the agreements constituted binding commitments to Colonial Bank’s primary federal regulator under §365(o) of the Bankruptcy Code. As a result, FDIC’s claim for priority was denied, entitling the FDIC to receive only a pro rata distribution with the other general unsecured creditors. The FDIC filed an appeal on September 13, 2010.

BACKGROUND

Prior to its bankruptcy, The Colonial Bancgroup, Inc. (the “Debtor”) was a bank holding company whose primary asset was Colonial Bank (the “Bank”). On June 30, 2009, the Debtor had $20 billion of deposits and assets in excess of $25 billion. After the Bank was closed and its branches and deposits were turned over to BB&T Corp., the Debtor listed assets of $45 million and liabilities of $380 million. The Debtor and its bank subsidiary had lost nearly $2 billion in 2008 and 2009 due in large part to defaults on loans to Florida builders and developers. Moreover, the Debtor provided substantial funding to Taylor, Bean & Whitaker Mortgage Corp., the nation’s 12th largest home lender, which filed for bankruptcy on the same day as the Debtor.1

About a year before the Debtor’s bankruptcy, in June 2008, the Bank converted itself from a national bank to an Alabama state-chartered, non-member bank (switching back to state regulation: some years before it had converted from a state bank to become a national bank). Because of the Bank’s conversion, its state regulator became the Alabama State Banking Department (“ASBD”), and its primary federal regulator became the FDIC.

In a letter dated October 9, 2008, the FDIC and the ASBD notified Colonial Bank that they were downgrading the Bank’s composite rating to a “3”, due to declining asset quality and the results of targeted examinations since the conversion. Shortly thereafter, in November 2008,

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1 The views and opinions in this article are entirely the author’s and not those of Miller, Canfield, Paddock and Stone or any of its clients.

2 See Steven Church & Edvard Petterson, Colonial Bancgroup Seeks Bankruptcy Amid U.S. Criminal Probe, BLOOMBERG, August 26, 2009.
the Federal Reserve Board informed the Debtor that, because of the Bank’s recent ratings downgrade, the Debtor was no longer in compliance with the requirement that the Debtor maintain the Bank in a “well-capitalized” and “well-managed” condition in order to continue to qualify as a “financial holding company.”

In December 2008, the Bank entered into a “Memorandum of Understanding” with the FDIC (the “Bank MOU”) in which the Bank agreed to “move in good faith to comply with the requirements of the [Bank MOU] and eliminate the problems of the Bank.” The Bank MOU required that the Bank obtain a Tier 1 Leverage Capital ratio of not less than 8% and a Total Risk-Based Capital ratio of not less than 12%. Similarly, a month later, in January 2009, the Debtor and the Federal Reserve executed an “Agreement Under the Bank Holding Company Act” (the “4(m) Agreement”) in which the Debtor agreed, among other things, to “take[e] steps designed to ensure that the Bank complies with the [Bank MOU], and any other supervisory action regarding the Bank…during the term of this agreement.”

Only a couple of weeks later, the Debtor signed a separate memorandum of understanding (the “Debtor MOU”) with the Federal Reserve. It is important to note here that the FDIC was not a party to the Debtor MOU. The Debtor MOU was an undertaking “in good faith” to “utilize its financial and managerial resources to assist its subsidiary bank.” The Debtor MOU, though, specifically stated that it is “not a ‘written agreement’ for the purposes of section 8 of the Federal Deposit Insurance Act.” Importantly, the Debtor MOU did not expressly require the Debtor to either infuse capital into the Bank or otherwise guarantee or pledge any assets to secure any Bank deficiency. The Debtor MOU did call for the Debtor to assist the Bank in complying with the Bank’s memorandum of understanding with the FDIC; that is, the Debtor was asked to assist the Bank in achieving the target capital ratios described in the Bank MOU.

The regulators’ actions escalated from informal to formal when the FDIC issued a cease and desist order with respect to the Bank (the “Bank C&D”) on June 15, 2009. The Bank C&D formalized the terms of the Bank MOU, requiring the Bank to achieve the target capital ratios by September 30, 2009. And about a month later, the Debtor consented to the issuance of a cease and desist order (the “Debtor C&D”) issued by the Federal Reserve and the Alabama State Banking Department. The Debtor C&D directed the Debtor to “take appropriate steps” to ensure the Bank complied with the Bank C&D. Notably, the Debtor C&D required the Debtor to submit a capital plan that would address the requirements of section 225.4(a) of Regulation Y that the Debtor serve “as a source of strength to the Bank” and also required the Debtor to notify the Federal Reserve and the ASBD after the end of any quarter in which its own capital ratios, or those of Colonial Bank, fell below the plan’s minimum ratios, and to include with the notification “an acceptable written plan that details the steps Bancgroup will take to increase its and/or the Bank’s capital ratios above the plan’s minimums.”

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3 See 12 C.F.R. § 225.81(b)(1).

4 The 4(m) Agreement was called for by section 4(m) of the Bank Holding Company Act, which requires bank holding companies that fail to maintain compliance with the requirements for financial holding company status to execute an agreement with the Federal Reserve to comply with such requirements. 12 U.S.C. § 1843(m)(2).
Despite their efforts, neither the Bank nor the Debtor was able to raise enough capital to satisfy the regulators, and on August 14, 2009 the ASBD closed the Bank and appointed the FDIC as receiver for the Bank. On August 25, 2009, The Colonial Bancgroup, Inc. filed for Chapter 11 bankruptcy in the United States Bankruptcy Court of the Middle District of Alabama.

THE BANKRUPTCY CASE

About three months after the Debtor’s bankruptcy filing, the FDIC filed a motion in the case to require the Debtor to immediately cure the large deficit under an alleged commitment to maintain the capital of the Bank or, in the alternative, to convert the case to a chapter 7 liquidation. The Court’s task, therefore, was to decide whether any of the various agreements between the Debtor, the Bank, and the regulators constituted a “commitment to a Federal depository institutions regulatory agency [or predecessor to such agency] to maintain the capital of” Colonial Bank within the meaning of section 365(o) of the Bankruptcy Code, 11 U.S.C. § 365(o).

Regulatory Framework

Because of the myriad of entities and regulators, as well as formal and informal actions, it may be useful to briefly describe some aspects of banking regulation as they apply to this case. The Debtor, as a bank holding company, was subject to regulation by the Board of Governors of the Federal Reserve System. The Bank, a state-chartered nonmember bank, was subject to the regulation at the federal level by the FDIC. The FDIC, the entity that filed the motion, is the primary federal regulator of state-chartered banks that do not elect to become members of the Federal Reserve System.

A key distinction in this case is that between informal and formal supervisory actions. Informal actions, such as the Debtor MOU, are “not enforceable” and their violation cannot serve as a basis for assessing a civil money penalty or initiating a removal and prohibition action. Generally, “[i]nformal supervisory tools are used when circumstances warrant a less severe form of action than the formal supervisory actions.” Informal actions are neither published nor generally publicly available. Federal regulators typically use these MOUs “when they do not

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5 According to testimony of Sarah Moore, the Debtor’s CFO, the Debtor’s application for TARP funds had been approved contingent upon additive capital of $300 million. Looking to receive $533 million in TARP funds, the Debtor contributed securities, loans, and cash to the Bank in the amount of $134 million. The Debtor worked with Taylor, Bean & Whitaker, as well as Promontory Financial Group in ultimately unsuccessful efforts to raise additional capital.


7 At the time of filing, the FDIC calculated the deficit at $904,954,360.

perceive the identified weakness as being an immediate threat to the safety and soundness of the bank.9

Formal actions, on the other hand, are enforceable and are required to be both published and made public.10 Cease and desist orders, which constitute a formal action, are generally used when the regulator finds that the entity has or will engage in a serious violation of law or regulation; or where the entity has engaged or is about to engage in some unsafe or unsound practice in conducting the business of the institution.11

The FDIC’s 365(o) Motion

The FDIC’s motion to cure the deficit under the alleged capital commitment was made under section 365(o) of the Bankruptcy Code. Generally, 11 U.S.C. § 365 addresses a bankruptcy trustee’s rights and responsibilities regarding the assumption or rejection of a debtor’s executory contracts and unexpired leases. Section 365(o), however, creates an exception to the trustee’s powers to reject burdensome executory agreements by requiring assumption of a capital maintenance commitment.12 This section seeks to “prevent institution-affiliated parties from using bankruptcy to evade commitments to maintain capital reserve requirements of a Federally insured depository institution.”13 Specifically, section 365(o) states that:

In a case under Chapter 11 of this title, the trustee shall be deemed to have assumed (consistent with the debtor’s other obligations under section 507), and shall immediately cure any deficit under, any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution, and any claim for a subsequent breach of the obligations thereunder shall be entitled to priority under

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9 See James M. Rocket, Confronting a Regulatory Crisis: A View From the Trenches During Troubled Times, 126 Banking L.J. 307, 311 (April 2009).
10 COMMERCIAL BANK EXAMINATION MANUAL §5040.1, supra note 8 at pp. 1-2.
11 Id. at pp. 1-5.
12 See Wolkowitz v. FDIC (In re Imperial Credit Industries, Inc.), 527 F.3d 959, 975 (9th Cir. 2008).
13 Resolution Trust Corp. v. Firstcorp, Inc. (In re Firstcorp), 973 F.2d 243, 246 (4th Cir. 1992) (quoting H.R.Rep. No. 681(I), 101st Cong., 2d Sess. 179 (1990), reprinted in 1990 U.S.C.C.A.N. 6472, 6585) (Congress enacted 365(o) to prevent a bank holding company that has committed to maintain the capital of its depository institution subsidiary from using Chapter 11 “to jettison the subsidiary in an effort to enhance its own financial position and that of its creditors.” In re Firstcorp, 973 F.2d at 248).
section 507. This subsection shall not extend any commitment that would otherwise be terminated by any act of such agency.  

In this case, if the Court had granted the FDIC’s 365(o) motion, the Debtor would have been required to cure the large deficit immediately. However, because the Debtor would have been unable to do so, the case would likely have been converted to a chapter 7 liquidation, the FDIC would have been entitled to a priority claim under §507(a)(9), and the FDIC would ultimately have benefited from a ninth priority under section 507, leaving lower priority unsecured claimants of about $400 million out of luck. The Court, however, held that the arguments raised in the FDIC’s 365(o) motion were unpersuasive, entitling the FDIC to only a pro rata distribution of the Debtor’s remaining assets with the other general unsecured creditors.

The Court’s Decision

The Bankruptcy Court ultimately held that the Debtor did not make a commitment to a federal depository institutions regulatory agency to maintain the capital of the Bank under § 365(o); and, even had the Debtor made such a commitment, that § 365(o) did not apply to such a commitment because the Bank was no longer operating on the date of the bankruptcy petition.

The Court made its decision by analyzing the content and context of the three agreements involving the Debtor: the 4(m) Agreement, the Debtor MOU, and the Debtor C&D. The Court found that the documents did not require the Debtor to comply on behalf of the Bank or impose any sort of liability on the Debtor in the event the Bank failed to reach the required capital ratios. According to the Court, the language in the documents merely required the Debtor to “assist” the Bank in reaching its goals.

The Debtor C&D

The FDIC’s strongest argument was based on the language of the Debtor C&D. The Debtor C&D, which, unlike the Debtor MOU, was a formal enforceable action, required the Debtor, under a paragraph titled “Source of Strength,” to “take appropriate steps to ensure that the Bank complies with the [Bank C&D].”

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14 11 U.S.C. 365(o). The original text of this section 365(o) covered “any commitment by the debtor to the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Director of the Office of Thrift Supervision, the Comptroller of the Currency, or the Board of Governors of the Federal Reserve System.” This section, though, was modified in 1994, in what was characterized as a technical amendment, by replacing the names of the specific entities with the current phrase “a Federal depository institutions regulatory agency (or predecessor to such agency).” Under the pre-1994 language of the provision, the fact that the obligation to maintain the Bank’s capital embodied in the Debtor C&D was imposed by the Federal Reserve, rather than the FDIC, would presumably not have prevented that obligation from receiving the special protection provided by section 365(o). Section 507(a)(9) gives ninth priority to such claims (“Ninth, allowed unsecured claims based upon any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor agency), to maintain the capital of an insured depository institution.”).

15 See Firstcorp, 973 F.2d at 248 (If the holding company is not financially able to satisfy its capital maintenance obligations, §365(o) denies it the opportunity to reorganize under Chapter 11, leaving liquidation under Chapter 7 as its only option. Through this mechanism, §365(o) places the financial interest of the federal deposit insurance system ahead of that of the holding company and its creditors.).
The source of strength doctrine provides that a bank holding company shall “serve as a source of financial and managerial strength to its subsidiary bank and shall not conduct its operations in an unsafe or unsound manner.”\(^\text{16}\) In a footnote citing *MCorp. Fin. Corp. Inc. v. Board of Governors of the Federal Reserve*,\(^\text{17}\) the Court stated that the “source-of-strength doctrine does not require a bank holding company to make capital contributions to its subsidiaries.”\(^\text{18}\)

After analyzing the three documents at issue, the Court held that the “Debtor did not make a commitment to maintain the capital of the [Bank] within the meaning of § 365(o).” The Court only briefly mentioned the source of strength doctrine, instead choosing to parse the language of the agreements between the Debtor and the Board. The documents were peppered with terms like “assist” and “good faith.” In the Court’s view, no part of any of the three documents described any specific requirements; nor did any document mention any potential liability for the Debtor.

The Debtor C&D did, however, contain a section titled “Capital Plan” which required the Debtor to “submit a capital plan that would ‘address, consider and include,’ among other things, the Bank’s current and future capital requirements, the source and timing of additional funds to fulfill the Bank’s future capital requirements, and the requirements of section 225.4(a) of Regulation Y that the Debtor serve ‘as a source of strength to the Bank.’”\(^\text{19}\) This section also required the Debtor to notify the Federal Reserve if either the Debtor or the Bank’s capital ratios fell below the ratios described in the submitted capital plan. Together with such notification, the Debtor was required to submit a plan “that details the steps [Debtor] will take to increase its and/or the Bank’s capital ratios above the plan’s minimums.”\(^\text{20}\)

\(^\text{16}\) Regulation Y, 12 C.F.R. §225.4(a)(1).
\(^\text{18}\) Much has been written on the source of strength doctrine, and yet its force remains questionable. The Federal Reserve Board issued a policy statement in 1987 stating that “a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks in a manner consistent with the provisions of this policy statement.” *Policy Statement on the Responsibility of Bank Holding Companies to Act as Sources of Strength to their Subsidiary Bank*, 52 Fed. Reg. 15707, April 30, 1987, effective April 24, 1987. According to this policy, the Federal Reserve Board is asserting its authority to compel a bank holding company to assist a subsidiary bank. See Milton R. Schroeder, Esq., *LAW & REG. OF FIN. INST.* at §5.08, *The Federal Reserve Board Source of Strength Policy*, (A.S. Pratt & Sons, July 2010). Yet this case, as well as the *MCorp Financial* case, beg the question of what the source of strength doctrine actually requires a bank holding company to do. The Source of Strength doctrine is addressed in the Dodd-Frank Wall Street Reform and Consumer Protection Act in Section 38A which states that “[t]he appropriate Federal banking agency for a bank holding company or savings and loan holding company shall require the bank holding company or savings and loan holding company to serve as a source of financial strength for any subsidiary of the bank holding company or savings and loan company that is a depository institution.”

\(^\text{19}\) *In re The Colonial Bancgroup, Inc.*, Case No. 09-32303, at p. 6 (citing the Debtor C&D, at ¶ 2).
\(^\text{20}\) Debtor C&D at ¶ 2
Nonetheless, finding that the documents lacked specificity and any binding language, the Court held that nothing in the three documents constituted a “commitment” as that term is used in §365(o).

§365(o) Only Applies to Commitments Made to ‘Federal Depository Institutions Regulatory Agency’

The Debtor argued that, because none of the agreements were executed between the Debtor and the FDIC, such agreements, and anything contained within, were not subject to §365(o). None of the three agreements involving the Debtor involved the FDIC, which is the entity that filed the § 365(o) motion. Section 365(o) embraces only commitments made to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution. With respect to an insured depository institution for which the FDIC has been appointed receiver, such agency is the FDIC. Moreover, section 3(q) of the Federal Deposit Insurance Act identifies the FDIC as the “appropriate Federal banking agency” for state nonmember insured banks. In other words, at all relevant times, the FDIC was the appropriate federal agency.

It is understandable that the Debtor did not make any commitments to the FDIC; as a bank holding company, the Debtor’s regulator throughout its existence was the Board of Governors of the Federal Reserve System. The Court discussed a number of cases where a depository institution holding company made commitments to the subsidiary institution’s regulator. In each of those cases, though, the commitments were made as a condition of approval of the acquisition of a bank or in response to a prompt corrective action order. The situation in this case was quite different. The Debtor already owned the Bank at the time of its various agreements with federal banking regulators, and a prompt corrective action order was never issued.

In any event, the FDIC was clearly not a party to either the 4(m) Agreement, the Debtor MOU, or the Debtor C&D. As such, the Court held that any commitment contained in the documents to maintain the capital of the Bank did not come within the meaning of §365(o) because such commitment was not made to the FDIC, the Federal depository institutions regulatory agency with respect to a state non-member bank.

The Various Agreements Were Not Enforceable Because the Bank was Closed Prior to the Debtor’s Bankruptcy Petition


23 Franklin Savings Corporation v. Office of Thrift Supervision, 303 B.R. 488 (D. Kan. 2004) (debtor did not dispute that it made a capital maintenance commitment); Resolution Trust Corp. v. Firstcorp, Inc. (In re Firstcorp), 973 F.2d 243 (4th Cir. 1992) (commitment made as a condition to acquiring thrift); Office of Thrift Supervision v. Overland Park Fin’l Corp. (In re Overland Park), 236 F.3d 1246 (10th Cir. 2001) (commitment made as a condition to acquiring thrift); Wolkowitz v. FDIC (In re Imperial Credit Industries, Inc.), 527 F.3d 959 (9th Cir. 2008) (holding company’s guarantee of capital restoration plan after prompt corrective action was required by federal law).
The Debtor further argued that because none of the commitments were enforceable, section §365(o) did not apply. The Debtor MOU expressly stated that it “is not a ‘written agreement’ for the purposes of Section 8 of the Federal Deposit Insurance Act.” A “written agreement,” unlike a memorandum of understanding, would be a formal, enforceable enforcement action. The Debtor MOU, as an informal action, was not enforceable. The Debtor MOU, though, was superseded by the Debtor C&D, which is enforceable. As stated above, the Debtor C&D asked the Debtor to assist the Bank in complying with its own Bank C&D. The Bank, though, was shut down on August 14, 2009. The Debtor argued that the Bank C&D was terminated on that same date.

The Court stated that §365(o) contemplated a commitment that, on the date of the bankruptcy petition, can be assumed and cured. The Bank was closed on August 14, 2009, and the Debtor’s obligation under the Debtor C&D was to continue until September 30, 2009. The Debtor, though, filed for bankruptcy protection on August 25, 2009. The Court stated that “[w]ith the closing and sale of the Bank, the purpose for the commitment could no longer be fulfilled, and the performance under the commitment was impossible.”

A similar argument was considered and rejected in the Firstcorp case. There, the debtor claimed that because its subsidiary was placed in receivership, any commitment it had with its regulator terminated. The court held, “that termination, however, operated only to absolve Firstcorp of any obligation to continue maintaining [its subsidiary’s] capital and thereby cleared it of any liability arising from further deterioration of [the subsidiary]’s capital.” The court in Firstcorp recognized that “[u]nder Firstcorp’s interpretation, a holding company obligated to maintain the capital of a depository institution could avoid that obligation entirely simply by ignoring it: once the institution’s financial position deteriorated to such an extent that federal regulators were forced to step in and take control, the holding company could argue that its liability under the capital maintenance obligation was thereby extinguished. Congress could not have intended such a result.”

The Court gave some recognition to the holding in Firstcorp in a footnote. The Court stated that “the court is not holding that because the bank closed, there can be no claim for any prepetition breach of an enforceable commitment. The court is holding merely that section 365(o) does not apply to such commitments, and any claim for a prepetition breach must be addressed through 11 U.S.C. § 507(a)(9)”, which gives ninth priority status to such commitments. And so, the Court held that §365(o) does not apply to a capital maintenance commitment where the commitment cannot be assumed and cured because the underlying depository institution is no longer operating.

CONCLUSION

This opinion, assuming it withstands review, is troubling for federal regulators going forward. Here, there was little doubt what the regulators were asking the Debtor and the Bank to

24 See COMMERCIAL BANK EXAMINATION MANUAL, Doc. #701, Ex. 8, p. 56.

25 In re Firstcorp, 973 F.2d at 251 (emphasis in original).

26 Id.
do; that is, raise capital lest the Bank be shut down. Clearly the Debtor understood this directive because it made efforts to raise capital and to institute a management plan. Nonetheless, because the various documents, in the Court’s view, did not contain a sufficiently explicit and formal undertaking by the Debtor to provide capital to the Bank, the Court deemed that they were not in fact “commitments.”

However, even a more clearly written cease and desist order would not have resulted in a different outcome in this case. To withstand the Court’s analysis, any commitment by the Debtor would have to been made to the FDIC, as the “Federal depository institutions regulator” with respect to Colonial Bank. Moreover, in the Court’s view, only if the Bank were closed after the Debtor filed bankruptcy would the commitment under §365(o) apply.

There is little doubt that the FDIC’s ability to proceed against bank holding companies is critical if it wishes those companies to honor any promises to shore up a subsidiary bank’s capital. Assuming the Court’s decision is upheld in the coming appeal, the Federal Reserve, as holding company regulator, may wish to add the Federal depository institutions regulator of the subsidiary bank as a party to any supervisory orders directing the infusion of capital into such a subsidiary, or at least modify the language of such orders to explicitly provide that the subsidiary’s primary federal regulator is an intended beneficiary of any capital commitment by a depository institution holding company.
With each passing week, the roster of failed banks continues to grow. In the first three quarters of 2010, more than 125 financial institutions failed, putting the year on-pace to exceed 2009’s 140 failures.\(^2\) Since the beginning of the financial crisis in 2007, more than 300 banks have been placed into FDIC receivership, with assets exceeding $634 billion.\(^3\)

The relentless pattern of weekly bank failures is echoed in the increasing number of institutions on the FDIC’s list of problem institutions (more than 800 as of the most recent FDIC Quarterly Banking Profile). The size of that inventory of severely distressed institutions means that the “new normal,” in which every Friday brings the failure of at least one financial institution, is likely to continue into the foreseeable future.

**The Strategic Opportunity**

A key challenge for the FDIC is balancing its goal of minimizing cost to the insurance fund with the need to ensure a ready supply of eager, willing and qualified buyers for failed depository institutions.

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The opinions expressed are those of the author, and do not represent the views of the firm or its partners. This article does not constitute, and should not be treated as, legal advice.

institutions. The incentive for healthy banks and other qualified entities to acquire the assets of failed banks in FDIC-assisted acquisitions is the value of the target bank’s core deposits and franchise, combined with the opportunity to limit credit loss exposure pursuant to the FDIC’s loss-share arrangement. That combination represents what many consider an invaluable strategic opportunity for buyers.

However, over the last twelve months the FDIC, consistent with its statutory mandate and vigilant attention to reducing cost to taxpayers, has made a ongoing series of changes to the loss share arrangement. For those considering an acquisition of a failed bank from the FDIC, staying current on the financial impact of these developments is critical to informed decision-making, more precise estimates of the value of the institution acquired and more successful bidding.

**A Unique Counterparty**

To prepare effectively for FDIC-assisted transactions, it is essential to understand the unique nature of the transaction and the seller. First, all of the FDIC’s activities with regard to failed bank receiverships and asset sales are guided by its statutory mandate to achieve the least cost for the insurance fund.\(^3\)

Second, the FDIC operates with the benefit of statutory insulation from normal contractual restrictions to which other parties are generally bound. For instance, the FDIC has the statutory right to repudiate contracts or agreements to which the failed bank was a party, notwithstanding

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\(^3\) *Id.*

any provisions granting rights to the counterparty for early termination or default.\(^5\) Likewise, when the FDIC acts as receiver, contractual restrictions on transfer are moot, generally allowing it to assign contracts and agreements to the assuming institution without restriction.\(^6\)

Lastly, the FDIC requires a smooth, quick and efficient process for closing failed banks in a manner that instills confidence among depositors and the public. As one component to that efficient process, the key provisions of the FDIC’s transaction documents (principally the Purchase and Assumption or “P&A Agreement”) pursuant to which assets and liabilities are purchased by the assuming institution are generally non-negotiable.

The Loss-Share Process

Another unique aspect of FDIC-assisted acquisitions, and indeed a key to the value proposition in most of these transactions, is the loss-share arrangement with the FDIC. The overwhelming majority of failed bank purchases in the last two years have been pursuant to P&A Agreements with loss share.

The P&A Agreement sets forth detailed conditions that must be satisfied in order for losses and expenses to qualify for reimbursement. Upon acquisition of a failed bank, purchasers must immediately put into place robust business processes to ensure compliance with the myriad deadlines and requirements reflected in the P & A Agreement and ensure that all reporting requirements are made timely and completely. Failure to satisfy those conditions can jeopardize the FDIC financial guarantee. If an asset is covered by loss share and the purchaser fails to

manage that asset properly within the parameters of the FDIC loss-share agreement, a “covered asset” otherwise subject to FDIC coverage can easily become a 100 percent loss.

**Ongoing Changes to the Loss Share Protocol**

In earlier versions, the P&A Agreement stipulated that losses on all assets of a failed bank purchased by an assuming institution from the FDIC were shared between the FDIC and the assuming institution on an 80% / 20% basis up to a stated threshold, after which losses were shared on a 95% / 5% basis. That is, the FDIC would reimburse the assuming institution for up to 80% of the losses up to the stated threshold (specific to each individual transaction), after which the FDIC would reimburse the assuming institution for up to 95% of the losses.

Early in 2010, the FDIC changed the P&A Agreement to reflect a uniform split that reduced the loss share percentage to 80% / 20%, eliminating the opportunity for 95% coverage for the assuming institution after the specified threshold had been exceeded. Significantly, later in the year, the FDIC further refined the formula to eliminate the static 80% / 20% loss share formula, and invited bidders to bid competitively for the percentage of losses it required the FDIC to assume, up to a maximum FDIC loss coverage of 80%.

Recently the FDIC has further revised its formula, making the overall process increasingly complex for bidders. As a result of the latest changes, the FDIC now announces three tranches for potential losses. These tranches vary in size and are specific to each transaction. For instance, Tranche #1 might be all losses from zero to ten million dollars, Tranche #2 might be all losses over ten million dollars up to $40 million, and Tranche #3 might be all losses exceeding $40 million.

For one of the three tranches (Tranche #2), the FDIC determines the loss share percentage (not to exceed 80%). The FDIC announces this percentage of loss share coverage for Tranche #2
approximately one week prior to the bidding deadline. For the remaining two tranches (Tranches #1 and #3), the bidders each bid on the loss share percentage (not to exceed 80% as the FDIC’s share).

In addition, originally the FDIC’s loss share percentage was consistent with respect to all types of assets acquired by the assuming institution. However, the FDIC’s bidding process now requires potentially different loss share percentages for each of the single family (one-to-four family residential real estate) and commercial asset portfolios. Bidders may propose different loss share percentages, for two of the three tranches, for each of the two portfolios. Also, loss share coverage has been eliminated entirely for consumer loans (defined generally as loans to individuals for household, family and other personal expenditures, not secured by real estate).

Each of the changes described above are evidence of the FDIC’s ongoing commitment to its central statutory mandate, that is, reducing cost to the insurance fund. Obviously, the FDIC’s efforts to reduce potential cost to taxpayers makes the process more complex and challenging for potential bidders. Each bidding team is now faced with the challenge of constructing bids that not only incorporate a discount (or premium) on the assets, a premium (if any) on the deposits, but also a loss share percentage for four separate asset tranches (that is, Tranches #1 and #3 for each of the single family and commercial portfolios). As a result, now more than ever, competitive advantage in the bidding process will go to those bidders who are well-prepared.

**The Impact of Recent Bidding Protocol Changes**

The FDIC’s use of the new bidding protocol described above has been noteworthy for the aggressive approach it reflects to loss share percentages for the Tranche #2 losses.
For instance, for the first transactions to close under the newest bidding protocol, the FDIC set the Tranche #2 loss share percentages at 0% in most instances, and at 20% or 30% in a few cases.

September 10:
Horizon Bank, Bradenton, FL (Single Family **30%**, Commercial **0%**)

September 17:
First Commerce Community Bank, Douglasville, GA (Single Family **0%**, Commercial **0%**)
People's Bank, Winder, GA (Single Family **20%**, Commercial **30%**)
Bank of Ellijay, Ellijay, GA (Single Family **0%**, Commercial **0%**)

September 24:
North County Bank, Arlington, WA (Single Family **0%**, Commercial **0%**)
Haven Trust Bank, Ponte Vedra Beach, FL (Single Family **0%**, Commercial **0%**)

**Multiple Bids**
In recognition of the increasingly competitive bidding environment, the FDIC encourages bidders to submit multiple bids. For instance, bidders may submit multiple bids with varying loss share percentages for the four tranches on which they can bid. For the same target, however, they can also submit variations on that bid, including different loss share percentages or deposit premiums. In addition, the FDIC allows bidders to make bids with and without loss share coverage, on the same failed bank target.

**Other P&A Changes**
The latest versions of the P&A Agreement also include other changes that merit review by potential bidders and their professional advisors, including:

- Bidders will now bid the asset premium (or discount) as a set dollar amount, rather than a percentage.
• Conversely, the premium on deposits, if any, continues to be bid as a percentage amount.

• Mortgage servicing rights are no longer included in those assets to be acquired by the assuming institution.

• The P&A Agreement has revised its treatment of letters of credit. Newly-added language now clarifies the circumstances in which assumption of liability can be limited to the market value of the assets securing assumed letters of credit.

Conclusion

Serious potential bidders must be close observers of the FDIC’s evolving resolution process. The FDIC makes recent institution-specific P&A Agreements publicly-available on its web site approximately one week after each bank closing. Bidders should become familiar with those P&A Agreements as they are published, and watch the process closely for meaningful new developments.

There are likely to be hundreds of bank failures over the next several years. For well-prepared bidders willing to accept risk, failed bank acquisitions with loss-share protection will continue to offer excellent strategic growth opportunities.

* * *
Preemption Under Title X of the Dodd-Frank Act

By

Travis P. Nelson1

Introduction

On July 21, 2010, President Obama signed into law what is considered by most to be the most sweeping financial services legislation since the Great Depression. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act” or the “Act”) effects a variety of reforms to a broad cross-section of the financial services industry.2 Included within this legislative behemoth is the Consumer Financial Protection Act of 2010, codified at Title X of the Dodd-Frank Act. One of the most hotly contested issues of Title X, and of the entire Dodd-Frank Act for that matter, is the scope of federal preemption of state consumer financial laws, and the role of states in enforcing compliance by federally-chartered institutions with consumer financial laws. This article examines the changed standards and role of preemption under the Act.

Discussion

Preemption

Pre Dodd-Frank Act

Traditionally, federally-chartered financial institutions have enjoyed considerable protection from potentially burdensome – and often hostile – state laws. In the National Bank Act (“NBA”),3 and the Home Owners Loan Act (“HOLA”),4 Congress has empowered national banks and federal savings associations, respectively, with a considerable degree of preemption against state laws relating to lending and other activities of those institutions. For nearly 200 years, the federal courts have supported federal law as being “supreme over state law with respect to national banking.”5 In fact, in the years since the NBA’s enactment in 1863 as a vehicle for bringing the country’s economy together, the U.S. Supreme Court has “repeatedly made clear that federal control shields national banks from unduly burdensome and duplicative state regulation.”6 Moreover, the Supreme Court has interpreted the NBA’s “grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law.”7

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2 Pub. L. 111-203.
3 12 U.S.C. § 1 et seq.
The weight of preemption accorded federal savings associations under HOLA has been even greater than that for national banks. The Supreme Court has recognized that in providing for the organization, incorporation, examination, operation, and regulation of federal savings associations through HOLA, “it would have been difficult for Congress to give the [OTS] a broader mandate.” According to the Supreme Court, HOLA governs “the powers and operations of every federal savings and loan association from its cradle to its corporate grave.” While some subsequent courts have interpreted this language to confirm that federal savings associations enjoy “field preemption” under HOLA and regulations of the Office of Thrift Supervision (“OTS”), at least one leading banking industry expert has observed that “[n]either de la Cuesta nor any other Supreme Court decision has specifically addressed whether the OTS’s reliance on field preemption is appropriate.”

In the exercise of their respective rulemaking powers against the above preemption backdrop, the OCC and the OTS have issued regulations broadly declaring whole categories of state laws to be preempted as applied to their regulated institutions. For example, the OCC’s lending regulations have declared that state laws regarding such topics as licensing and registration, the terms of credit, disclosure and advertising, disbursements and repayments, interest rates, and loan origination and servicing, are generally preempted. The OTS’s regulation takes a similar approach in its regulation on preempted state laws.

Preemption Under the Dodd-Frank Act

The Act provides clarification of the preemption of state consumer financial laws as applied to national banks and federal savings associations. The Act adds a new section to the NBA, which “clarifies” the standard of preemption applied to national banks. Under this provision a state consumer financial law is only preempted as applied to national banks if: (a) the state law discriminates against national banks as compared to state banks; (b) the law “prevents or significantly interferes with the exercise by the national bank of its powers,” in accordance with the Supreme Court’s decision in Barnett Bank, as determined by the Comptroller of the Currency on a case-by-case basis or by a court; and (c) the law is preempted by another law.

The Act preserves the authority of the Comptroller of the Currency to issue case-by-case preemption determinations. In making such determinations, the Comptroller must address “the impact of a particular State consumer financial law on any national bank that is subject to that law, or the law of any

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9 Id. at 145.
10 Silvas v. E*Trade Mortgage, 514 F.3d 1001, 1005 (9th Cir. 2008); Conf. of Fed. Sav. & Loan Associations, 604 F.3d 1256, 1257-1260 (9th Cir. 1979).
11 Julie L. Williams, Savings Institutions: Mergers, Acquisitions and Conversions, § 17.01, pg. 17-4.
12 12 C.F.R. § 34.4; 12 C.F.R. § 560.2.
13 12 C.F.R. § 34.4(a).
14 12 C.F.R. § 560.2.
15 Dodd-Frank Act § 1044(a).
16 Id.
State with substantively equivalent terms.”

Some practitioners have posited that the Act creates two different preemption standards, one to be applied to state consumer financial laws, and the other to be applied to other state laws that purport to infringe upon a national bank’s powers. This view is largely the result of the Act’s application of the clarified standards to “state consumer financial laws,” which under the Act include a state law that “specifically regulates the manner, content, or terms and conditions of any financial transaction authorized for national banks to engage in, or any account related thereto, with respect to a consumer.”

In other words, according to some practitioners, if a state law does not fit within the Act’s definition of a “state consumer financial law,” the preemption standards clarified in § 1044 of the Act would not apply.

The notion that the Act results in two distinct preemption regimes for national banks is certainly subject to dispute. The three basic categories of preempted state laws announced by § 1044(a) – (1) discriminatory state laws; (2) laws that “substantially interfere” with federal law under Barnett Bank; and (3) state laws that are preempted under another federal law – are not new. Prior to the Dodd-Frank Act, the courts have held that state laws that implicated one of these three preemption standards are preempted. State laws that discriminate against national banks have long been preempted. The application of Barnett Bank as the standard for determining the preemption of state laws as applied to national banks pre-existed the Act. Further, the notion that a state law may be preempted by more than one federal law is nothing new. Thus, the preemption standards announced at § 1044(a) of the Act arguably merely reaffirm the current state of the law, and do not establish two different preemption standards.

Similarly, the Act’s approach to case-by-case preemption determinations by the OCC is not necessarily groundbreaking. Under the Act, as discussed above, when the Comptroller is to make a case-by-case determination that a particular state law is preempted, the Comptroller’s decision must be based on substantial evidence “made on the record of the proceeding.” The Act is silent, however, as to

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17  Dodd-Frank Act § 1044(a).
18  Id.
19  Id.
22  Several federal courts have held that anti-preemption language, such as the language in the Dodd-Frank Act that state law is not inconsistent with the Act merely because it provides greater protection for the consumer than the Act, does not save the state law from being preempted by another federal law. See, e.g., Bank of America v. City & County of San Francisco, 309 F.3d 551 (9th Cir. 2002) (holding that while California state law may not be preempted by the Electronic Funds Transfer Act, it is preempted by the NBA); Bank One v. Guttau, 190 F.3d 844 (8th Cir. 1999) (same); U.S. v. Locke 529 U.S. 89 (2000) (anti-preemption clause in Oil Pollution Act did not “extend to subjects addressed in the other titles of the Act or other acts” and therefore did not preclude preemption of state laws by Ports and Waterways Safety Act); Int’l Paper Co. v. Ouellette, 479 U.S. 481 (anti-preemption clause in citizen-suit provisions of the Clean Water Act did not “preclude preemption of state law by other provisions of the Act.”).
23  Dodd-Frank Act § 1044.
what type of “proceeding” is required. Congress’ approach of requiring the OCC to provide some support for its regulatory determinations that a particular state law is preempted is a natural continuation of the views taken by the Supreme Court, even if implicitly, that preemption determinations or regulations made by mere administrative fiat and without a well-supported basis in legislation are no longer an acceptable agency practice.24

It would appear then, that Congress has not in fact altered the preemption landscape so much as it has clarified the existing standards that the OCC is expected to follow. Further, while the definition of “state consumer financial law” is certainly broad, there are several notable classes of laws that do not relate to the manner, content, or terms and conditions of a financial transaction or account, and therefore would not appear to be subject to the provisions relating to state consumer financial laws. These may include state licensing requirements, unfair or deceptive acts or practices laws, and disclosure or advertising laws.

**HOLA Preemption**

As discussed above, the HOLA and OTS regulations have enjoyed exceedingly broad preemptive priority over state laws. The Dodd-Frank Act however, changes this by explicitly eliminating any impression that HOLA and its implementing regulations are to be accorded field preemption.25 Moreover, the Act explicitly harmonizes the preemption standards under HOLA to conform to the NBA standards. In addition to eliminating a key comparative advantage of the federal savings association charter over the national bank charter, this provision may also effectively moot many OTS or Federal Home Loan Bank Board (“FHLBB”) legal opinions that relied on the perceived field preemption.

**Operating Subsidiaries and Agents**

Prior to the Dodd-Frank Act, the courts had recognized that the preemption protections of the NBA and the HOLA extend to activities conducted for federally-chartered institutions by their operating subsidiaries and agents. In *Watters*, the Supreme Court held that state laws apply to operating subsidiaries only to the extent that they apply to the depository institutions themselves.26 Moreover, three federal circuit courts of appeal have held that where a federally-chartered institution chooses to act through an independent agent, the activities that the agent engages in (consistent with the agency relationship) are protected by the preemption umbrella.27 The Act eliminates this preemption.

Under the Dodd-Frank Act, state law will no longer be preempted as applied to operating subsidiaries and agents of federally-chartered institutions.28 The likely consequence of this action will be federally-chartered institutions rolling their operating subsidiaries into the parent institutions, and the discontinuation of working through agents. Institutions will lose the limited liability that operating

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24 The Supreme Court’s decisions in *Watters* (dealing with operating subsidiaries), and in *Cuomo v. Clearing House Association*, 129 S.Ct. 2710 (2009) (dealing with visitorial powers), reflect the Court’s apparent apathy for such summary preemption determinations.
25 Dodd-Frank Act § 1046(a).
27 See, e.g., *SPGCC v. Ayotte*, 488 F.3d 525 (1st Cir. 2007); *SPGCC v. Blumenthal*, 505 F.3d 183 (2d Cir. 2007); *State Farm Bank, F.S.B. v. Reardon*, 539 F.3d 336 (6th Cir. 2008).
28 Dodd-Frank Act § 1044-1045.
subsidiaries allowed. Further, the convenience of acting through agents rather than employees, allowed institutions to broaden their markets, will no longer be available.

Visitorial Powers

The Dodd-Frank Act codifies the Supreme Court’s holding in Cuomo v. Clearing House Association. In Cuomo, the Supreme Court was asked to resolve the question of whether and to what degree the NBA’s reservation of visitorial powers in the OCC divested state law enforcement authorities of the power to enforce non-preempted laws against national banks.

**Cuomo** arose after Eliot Spitzer, then the attorney general of the State of New York, sent letters to several national banks, requesting “in lieu of subpoena” that they provide certain non-public information about their lending practices. Spitzer sought this information to determine whether the banks had violated the state’s fair-lending laws. The Clearing House and the OCC brought suit to enjoin the information request, claiming that the Comptroller’s regulation, promulgated under the NBA prohibits that form of state law enforcement against national banks. The district court entered an injunction in favor of the Clearing House and the OCC, prohibiting the attorney general from enforcing state fair-lending laws through demands for records or judicial proceedings. The U.S. Court of Appeals for the Second Circuit affirmed.

The OCC regulation provides that “[o]nly the OCC or an authorized representative of the OCC may exercise visitorial powers with respect to national banks” and that “[s]tate officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances authorized by federal law.” For purposes of this section, visitorial powers include: (i) examination of a bank, (ii) inspection of a bank’s books and records, (iii) regulation and supervision of activities authorized or permitted pursuant to federal banking law, and (iv) enforcing compliance with any applicable federal or state laws concerning those activities.

The OCC based this regulation on the NBA provision that: “No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.”

Under the OCC’s view of the rule, the denial of visitorial powers to the states as to national banks precludes both (a) examining the corporate affairs of the institution, including audits and inspection of books and records, as well as (b) enforcement of laws applicable to national banks. While the OCC accepted that some statutes are not preempted as to national banks, the OCC argued that it retains exclusive authority to enforce any law against a national bank. In other words, “the State may not enforce its valid, non-preempted laws against national banks.” This view, according to the Court, would yield a “bizarre” result.

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29 12 C.F.R. § 7.4000.
30 12 C.F.R. § 7.4000. The analog under OTS regulations is 12 C.F.R. § 545.2.
31 12 U.S.C. § 484. The analog for federal savings associations is Section 5 of the HOLA.
In holding that the OCC’s regulation interpreting the NBA was erroneous, the court noted the distinction between visitorial powers that are foreclosed to the states by the NBA, and enforcement of non-preempted laws, which remains the prerogative of the states. According to the Court: “‘Visitorial powers’ in the National Bank Act refers to a sovereign’s supervisory powers over corporations. They include any form of administrative oversight that allows a sovereign to inspect books and records on demand, even if the process is mediated by a court through prerogative writs or similar means. The Comptroller reasonably interpreted this statutory term to include ‘conducting examinations [and] inspecting or requiring the production of books or records of national banks,’ . . . When, however, a state attorney general brings suit to enforce state law against a national bank, he is not acting in the role of sovereign-as-supervisor, but rather in the role of sovereign-as-law-enforcer. Such a lawsuit is not an exercise of ‘visitorial powers’ and thus the Comptroller erred by extending the definition of ‘visitorial powers’ to include ‘prosecuting enforcement actions’ in state courts.”

While the Court did effectively strike down the OCC’s regulation, the decision did not give state attorneys general carte blanche to initiate enforcement proceedings against national banks. First, the Court sustained the lower court's injunction against the New York attorney general’s issuing of executive subpoenas seeking non-public materials from national banks. Thus, state officials are still prohibited from bringing administrative enforcement actions against national banks. Under this decision, however, state officials are permitted to bring lawsuits to compel national banks’ compliance with the law.

Second, the Court’s decision does not change the preemptive effect of the NBA or OCC regulations as to substantive law. In other words, state officials may enforce any non-preempted law for which they retain enforcement authority. As a practical matter, this limitation leaves open non-preempted state laws, such as those governing real estate and criminal matters, as well as laws that supplement federal statutes, such as in the area of discrimination. In noting its approval of such a framework, the Court stated: “Channeling state attorneys general into judicial law-enforcement proceedings (rather than allowing them to exercise ‘visitorial’ oversight) would preserve a regime of exclusive administrative oversight by the Comptroller while honoring in fact rather than merely in theory Congress’s decision not to preempt substantive state law. This system echoes many other mixed state/federal regimes in which the Federal Government exercises general oversight while leaving state substantive law in place.”

The Cuomo court used the example of the OCC’s visitorial powers preemption regulation to make a broader statement about preemption regulations generally. As referenced above, in the Watters decision the Court explicitly declined to examine the deference to be accorded the OCC’s operating subsidiary regulation, calling such an exercise “an academic question.” Instead, the Watters Court undertook a classical preemption analysis, delving into the NBA itself to determine that preemption applied to the activities of an operating subsidiary of a national bank. This dismissiveness displayed by the Watters majority to preemption regulations was more explicit in the Watters dissent, authored by Justice Stevens, and joined by Chief Justice Roberts and Justice Scalia: “[Congress has not] authorized an executive agency to preempt . . . state laws whenever it concludes that they interfere with national bank activities.” And later: “Until today, we have remained faithful to the principle that nondiscriminatory laws of general application that do not ‘forbid’ or ‘impair significantly’ national bank activities should not be preempted.” The minority view in Watters became the law in Cuomo, and has been codified in Dodd-Frank Act § 1047 for both national banks and federal savings associations.
After *Cuomo* and § 1047, we are likely to see an increase in state attorneys general using their law enforcement powers to bring lawsuits to force compliance with non-preempted state law and federal laws for which they retain supplemental jurisdiction. While the codification of *Cuomo* will likely result in an increase in litigation by state attorneys general, it also provides greater clarification that state attorneys general may not attempt to utilize their broad and often intrusive investigatory powers. Such litigation by state attorneys general will undoubtedly include enforcement of Title X of the Act. Importantly while state attorneys general may enforce regulations prescribed by the Bureau of Consumer Financial Protection (the “Bureau”), they may not enforce the Act itself against national banks and federal savings associations.32

**Interest Rate Exportation**

Under the NBA and the HOLA, national banks and federal savings associations may “export” the interest rates permitted by their home state.33 This exportation power, sometimes referred to as “most favored lender authority,” permits federally-chartered institutions to charge interest at the rate allowed by the laws of the state where they are located, even when making loans to borrowers in other states.34 The NBA defines “interest” for purposes of the exportation power as “any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended.”35 The term interest includes a broad array of fees, such as the numerical periodic rate, late fees, NSF fees, overlimit fees, annual fees, and cash advance fees.

The Dodd-Frank Act preserves the ability of national banks to export interest rates. Specifically, the Act provides: “No provision of this title shall be construed as altering or otherwise affecting the authority conferred by section 5197 of the Revised Statutes of the United States (12 U.S.C. § 85) for the charging of interest by a national bank at the rate allowed by the laws of the State, territory, or district where the bank is located, including with respect to the meaning of ‘interest’ under such provision.”36 Though this provision only explicitly refers to national banks, as the Dodd-Frank Act amends the HOLA to incorporate the preemption provisions in the NBA, this exportation power would presumably continue for federal savings associations under HOLA.37

**Conclusion**

The changes and clarifications brought by Title X of the Act will undoubtedly have a substantial and sustained impact on national banks and federal savings associations. How such institutions navigate the Act and the labyrinth of new regulations that are expected to follow, will depend largely on whether such institutions take proactive steps in the near term to prepare themselves for the changes. In taking a proactive approach, institutions must begin by reviewing the range of state laws that

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32 Dodd-Frank Act § 1042(a)(2). This limitation to enforcement of Bureau regulations and not the Act itself will enable institutions to avoid the problem often encountered in the past of a regulator attempting to enforce a statute in the absence of implementing regulations, such as was the case when agencies attempted to enforce Section 5 of the Federal Trade Commission Act without implementing Federal Reserve Board regulations.


34 We note that an institution may be “located” in more than one state for exportation purposes.

35 12 C.F.R. § 7.4001(a); 12 C.F.R. § 560.110.

36 Dodd-Frank Act § 1044.

37 *Id.* at § 1044.
their activities may be subject to, and analyze whether the post Dodd-Frank Act preemption regime will protect the institutions from intrusive and burdensome state laws. Additionally, with the fact that the new Bureau will engage in substantial rulemaking, it will be crucial for institutions to actively participate in the rulemaking process by submitting comment letters that address the adverse impact that proposed regulations will have on the industry and on consumers.