THE BANKING LAW JOURNAL

VOLUME 129 NUMBER 10 NOVEMBER/DECEMBER 2012

THE BANKING LAW JOURNAL (ISSN 0005 5506) (USPS 003-160) is published ten times a year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. For subscription information and customer service, call 1-800-572-2797. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed — articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys.
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The Source-of-Strength Doctrine: Revered and Revisited – Part II

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This two-part article revisits the premises of the source-of-strength doctrine and analyzes its application to the new contours of the financial regulatory system set by the Dodd-Frank Act. The first part began with a brief history on the source-of-strength doctrine and then proceeded to a discussion of the arguments traditionally mounted in support of or in opposition to the doctrine to illuminate themes that will arise in the application of the doctrine in expanded form under the Dodd-Frank Act. This second part analyzes the new source-of-strength provision in the Dodd-Frank Act and the application and implications of the doctrine as a legal and policy matter for other types of depository holding companies and nonbank financial companies.

There are two prevailing (and some would say polemical) visions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] As with most visions, neither of these fully comports with reality. In one vision the Dodd-Frank Act represents a well-designed and benevolent measure that will remediate the financial regulatory system and enhance the safety and soundness of the U.S. financial system. In the other vision the Dodd-Frank Act represents an ill-conceived and feckless measure that will have the perverse effect of weakening the U.S. financial system and the greater U.S. economy. Under either vision the necessary starting point for analysis must be the individual provisions of the Dodd-Frank

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Act, followed by a comprehensive analysis of the interactive and cumulative effects of the individual provisions. Following this methodology, this article analyzes the individual provisions of the Dodd-Frank Act that relate to the source-of-strength doctrine and then the broader implications of the interaction of these provisions.

OVERVIEW OF THE DODD-FRANK ACT PROVISIONS RELATING TO THE SOURCE OF STRENGTH

There are a number of provisions in the Dodd-Frank Act that relate to the source-of-strength doctrine. Section 616(d) is the most important of these.[2] It creates a statutory codification of a source-of-financial-strength requirement, applicable not only to bank holding companies but also to all other companies that directly or indirectly control an insured depository institution. Sections 616(a) and (b) relate indirectly to the source-of-strength doctrine by codifying and clarifying the authority of the Board to impose capital requirements by rule and regulation on bank holding companies and savings and loan holding companies.[3]

Other provisions of the Dodd-Frank Act may also be seen to complement the policies behind the source-of-strength doctrine. Section 606(a) amends Section 4 of the Bank Holding Company Act (the "BHC Act") to require a financial holding company to be "well capitalized" and "well managed."[4] Section 606(b) amends the Home Owners' Loan Act ("HOLA") to require non-grandfathered savings and loan holding companies engaged in certain financial activities to meet the criteria, including the well-capitalized and well-managed criteria, applicable to financial holding companies under the BHC Act.[5]

Section 604 amends certain provisions of the BHC Act and HOLA that likewise implicate aspects of the source-of-strength regime. Section 604(a) amends Section 5(c)(1) of the BHC Act to strengthen the authority of the Board to obtain reports from a functionally regulated subsidiary of a bank holding company.[6] Section 604(b) amends Section 5(c)(2) of the BHC Act to strengthen the authority of the Board to examine functionally regulated subsidiaries of a bank holding company.[7] Section 604(g) makes similar amendments to HOLA to expand the authority of the Board to require reports from, and to examine, a functionally regulated subsidiary of a savings and loan holding company.[8] Also of particular note is Section 604(c)(2). It repeals Section 10A of the BHC Act (originally added to the BHC Act in 1999 as part of the Gramm-Leach-Bliley Act),[9] which imposed restrictions on the authority of the Board to take direct or indirect action against a functionally regulated subsidiary of a bank holding company.

Section 604 is also notable for what it did not do. Section 604 did not repeal or amend two other important subsections of Section 5 of the BHC Act that relate to functionally regulated subsidiaries. Section 604 did not repeal or amend subsection 5(c)(3) of the BHC Act, which provides that the Board may not prescribe or impose any capital rule or guideline on any functionally regulated subsidiary that is in compliance with the applicable capital requirements of its functional regulator.[10] Even more significant from the perspective of the source-of-strength doctrine, Section 604 did not repeal or amend subsection 5(g) of the BHC Act, which imposes restrictions on the authority of the Board to require a bank holding company to provide funds to a subsidiary depository institution if the funds are to be provided by a bank holding company that is itself a functionally regulated entity or by an affiliate that is a functionally regulated entity.[11] The restrictions of Section 5(g) of the BHC Act with respect to functionally regulated entities are also applicable to the other federal banking agencies by virtue of a provision in the Federal Deposit Insurance Act (the "FDIA").[12] The restrictions of Section 5(g) would thus appear to apply to the newly codified source-of-financial-strength provision in Section 616(d) of the Dodd-Frank Act, which takes the form of an amendment to the FDIA.

The Dodd-Frank Act expressly refers to a source-of-strength requirement in two other contexts. Section 167(b) provides for the possible establishment of an intermediate holding company by a nonbank financial company that has been designated under Section 113 of the Dodd-Frank Act.[13] Section 167(b)(3) provides that a company that directly or indirectly controls an intermediate holding company established pursuant to Section 167(b) "shall serve as a source of strength to its subsidiary intermediate holding company."[14] Likewise, Section 626 of the Dodd-Frank Act adds a new provision to HOLA, providing for the possible use of an intermediate holding company by a grandfathered unitary savings and loan holding company.[15] The provisions of Section 626 generally parallel the provisions of Section 167(b), including a requirement that any company that directly or indirectly controls an intermediate holding company established pursuant to Section 626 "shall serve as a source of strength to its subsidiary intermediate holding company."[16]

Additionally, the provisions of Section 165(d) requiring a systemically important bank holding company to submit a plan (or "living will") for its rapid and orderly resolution in the event of material financial distress or failure will implicate considerations under the source-of-strength doctrine.[17] Similarly, under Section 165(d), the resolution plan or living will of a nonbank financial company designated under Section 113 will involve considerations of the source-of-strength doctrine if that nonbank financial company controls an insured depository institution or an intermediate holding company established pursuant to Section 167(b).

Finally, the direct and indirect effects of the source-of-strength doctrine must be considered in the context of the new orderly liquidation regime established by Title II of the Dodd-Frank Act. The orderly liquidation authority under Title II is largely modeled on the receivership provisions of the FDIA.[18] It does not include an express provision relating to a source-of-strength requirement or, in the case of a commitment to a federal regulatory agency to maintain the capital of an insured depository institution, a provision comparable to that in Section 507(a)(9) of the Bankruptcy Code.[19] The effect of the source-of-strength doctrine and of a commitment to maintain the capital of the insured depository institution in a Title II proceeding will present novel issues even by source-of-strength standards. Each of these provisions in the Dodd-Frank Act is analyzed below.

THE NEW SOURCE-OF-STRENGTH PROVISION

The most important provision of the Dodd-Frank Act relating to the source-of-strength doctrine is found in Section 616(d), which creates a statutory source-of-financial-strength requirement. Section 616(d) adds a new Section 38A to the FDIA. Subsection (a) of Section 38A provides as follows:

> The appropriate Federal banking agency for a bank holding company or savings and loan holding company shall require the bank holding compa-

> ny 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 holding company that is a depository institution.[20]

The Board is the appropriate federal banking agency for a bank holding company and effective as of July 21, 2011 for a savings and loan holding company.

The intent of Congress in adopting Section 38A was to impose a source-of-financial-strength requirement not only upon bank holding companies and savings and loan holding companies, but also on any other company that directly or indirectly controls an insured depository institution and is otherwise exempt from the holding company provisions of the BHC Act or HOLA. Thus, subsection (b) of Section 38A provides as follows:

> If an insured depository institution is not the subsidiary of a bank holding company or savings and loan holding company, the appropriate Federal banking agency for the insured depository institution shall require any company that directly or indirectly controls the insured depository institution to serve as a source-of-financial-strength for such institution.[21]

This provision means that either the Federal Deposit Insurance Corporation (the "FDIC") or the Office of the Comptroller of the Currency (the "OCC"), as the case may be, in its capacity as the appropriate federal banking agency, is required to impose a source-of-financial-strength requirement on companies that directly or indirectly control insured entities such as credit card banks, limited purpose trust companies, and industrial loan companies that are exempt under the BHC Act and limited purpose trust savings associations that are exempt under HOLA.[22] The FDIC and OCC have developed, independent of the source-of-strength doctrine, their own mechanisms for obtaining capital guarantees from controlling parties of such insured entities.[23] These mechanisms are unlikely to be replaced by the provisions of Section 38A. They provide or purport to provide clearer avenues for enforcing a claim against a controlling party. Section 38A will simply serve as an additional statutory basis for the existing regulatory practice. Subsection (c) of Section 38A also provides explicit statutory authority for the appropriate federal banking agency to require reports from a controlling company to assess the ability of the company to comply with the source-of-strength requirement in subsection (b) and to enforce compliance by such company.

By its terms, Section 38A took effect on July 21, 2011. Section 38A further provides that the appropriate federal banking agencies shall jointly issue final rules to carry out the section by July 21, 2012.[24] The federal banking agencies are reported to be engaged in a joint effort to produce these rules, which will presumably be published as proposed rules for comment.[25]

A critical element of Section 38A resides in its definitional subsection. Subsection (e) of Section 38A provides as follows:

> In this section, the term "source-of-financial-strength" means the ability of a company that directly or indirectly owns or controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution.[26]

The definition of "source-of-financial-strength" in Section 38A appears to differ from the scope of the Board's interpretation of the source-of-strength requirement in at least two respects. First, Section 38A refers to a "source-of-financial-strength" whereas the Board's source-of-strength requirement in Section 225.4(a)(1) of Regulation Y refers to a "source of financial and managerial strength."[27] Second, the definition of "source-of-financial-strength" in Section 38A refers to the "ability" of a company to provide financial assistance to an insured depository institution.[28] The definition does not expressly refer to an obligation to provide financial assistance to the insured depository subsidiary in the event of financial distress. The Board's 1987 policy statement envisions at a minimum that the source of strength requires that a holding company have the ability to provide financial assistance to its subsidiary bank.[29] But the policy statement stands for the broader proposition that a holding company must in appropriate cases *use* its available resources to provide capital funds to its subsidiary banks. The policy statement provides in relevant part as follows:

> It is the policy of the Board that in serving as a source of strength to its subsidiary banks, 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.[30]

This language in the policy statement encompasses not only the capacity for obtaining resources to assist a bank subsidiary, but also the actualization of that capacity by providing funds to the subsidiary. Elsewhere in the policy statement the Board indicates that a holding company should not withhold financial support from a subsidiary bank in a weakened or failing condition "when the holding company is in a position to provide support." Lest there be any doubt on this point, the policy statement further provides that:

> [a] bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary bank(s), including an unwillingness to provide appropriate assistance to a troubled or failing bank, will generally be considered an unsafe and unsound banking practice or a violation of Regulation Y, or both, particularly if appropriate resources are on hand or are available to the bank holding company on a reasonable basis.[31]

While the latter statement relies on some contingent elements, such as "appropriate resources" being on hand or "available" to the company "on a reasonable basis," it reserves full authority to the Board to make these determinations and to require by order appropriate assistance to the subsidiary bank.

It seems unlikely that the Board and the other federal banking agencies will choose to read the definition of "source-of-financial-strength" narrowly when they issue rules implementing Section 38A. Presumably, the rules will address not only the ability of the company to provide financial assistance to an insured depository subsidiary, but also reserve at a minimum the authority of the federal banking agency to direct that financial assistance in a specific form and amount be provided to the insured depository subsidiary. That direction could take the form of an order from the federal banking agency directing a holding company to contribute capital funds to a subsidiary. From the perspective of maximizing its position under the Bankruptcy Code, the

Federal banking agency should prefer that any such order be issued on consent from the holding company.[32]

The ultimate question is whether the language of Section 38A (putting managerial support aside) constitutes something more or less than the Board's historical interpretation of the source-of-strength doctrine with respect to bank holding companies. If the federal banking agencies conclude that the language of Section 38A (managerial support aside) codifies the Board's historical (and admittedly indeterminate) interpretation of the source-of-strength requirement, then the federal banking agencies will also have to decide whether to incorporate into any rule that they propose the current restrictions on the source-of-strength doctrine reflected in Section 5(g) of the BHC Act and Section 45 of the FDIA discussed further below. The federal banking agencies will also have to decide whether to draw any distinctions in the application of the source-of-financial-strength provision between bank holding companies and the other companies subject to the provision.

CAPITAL PROVISIONS IN THE DODD-FRANK ACT RELEVANT TO THE SOURCE OF STRENGTH

The reference to "ability" in the definitional subsection of Section 38A raises other questions. In its 1987 policy statement the Board observed that capital is "critical to the soundness of individual banking organizations and to the safety and stability of the banking and financial system."[33] This statement in context clearly applies to the insured subsidiary, but subsequent developments suggest that the statement could equally apply to the holding company of an insured subsidiary. The capital position of a holding company may be seen as an important (though not determinative) factor in assessing the ability of a holding company to provide financial assistance to an insured subsidiary. It is not entirely fortuitous that other provisions in the Dodd-Frank Act are intended to strengthen the capital regime for bank holding companies, savings and loan holding companies, and large systemically important bank holding companies and nonbank financial companies designated under Section 113 of the Dodd-Frank Act.

In a move that can best be described as confirmatory, Section 616(a) amends the BHC Act to provide that the Board may issue "regulations and orders relating to capital requirements for bank holding companies."[34] In a similar manner, Section 616(b) amends HOLA to provide that the Board may issue "regulations and orders relating to capital requirements for savings and loan holding companies."[35] The latter amendment is more than merely confirmatory. It may also be seen as hortatory. The Office of Thrift Supervision (the "OTS"), the prior regulator of savings and loan holding companies, had not issued capital rules for savings and loan holding companies; it relied instead on a capital adequacy analysis performed institution by institution.[36] The absence of capital rules for savings and loan holding companies was seen by some observers as creating arbitrage opportunities for savings and loan holding companies.[37] The congressional intent in adopting Section 616(b) suggests a desire for capital rules in some form for savings and loan holding companies.[38] Nonetheless, the variety of business models and enterprises represented by grandfathered savings and loan holding companies presents significant hurdles for the design of generic consolidated capital rules for these firms.

This challenge is compounded by the requirements of Section 171 of the Dodd-Frank Act.[39] Section 171 of the Dodd-Frank Act, added by the so-called Collins Amendment, requires the federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for bank holding companies, savings and loan holding companies, and designated nonbank financial companies, that are not less than or quantitatively lower than the leverage and risk-based capital requirements applicable to insured depository institutions as in effect on July 21, 2010. The effect of Section 171 is both to impose the pre-existing and in certain respects more stringent leverage and risk-based capital rules applicable to insured depository institutions on bank holding companies, savings and loan holding companies, and designated nonbank financial companies, and to establish the insured depository institution leverage and risk-based capital rules as in effect on July 21, 2010, as a floor for future leverage and risk-based capital rules for bank holding companies, savings and loan holding companies, and designated nonbank financial companies. The effects of these new requirements are mitigated by certain exclusions, deferments, and phase-in periods. For savings and loan holding companies, for example, the effective date of these provisions is generally postponed until July 21, 2015.[40] In their initial rulemaking to provide for implementation of the requirements of Section 171, the federal banking agencies sought to preserve some flexibility to address the application of risk-based capital requirements to entities such as designated nonbank financial companies and savings and loan holding companies that had not previously been subject to bank-like consolidated capital requirements.[41] In proposing the rules, the federal banking agencies noted that such entities might present different exposure types and risks than those contemplated when the bank risk-based capital requirements were developed. As an example, they cited exposures by insurance companies that would automatically default to a 100 percent risk weight because the bank risk-based capital requirements do not make provision for such nonbanking exposures.[42]

The reference to "ability" in subsection (e) of Section 38A raises the possibility that the federal banking agencies in their implementing rules under Section 38A will incorporate an analysis of the capital position of a company subject to subsection (b) of Section 38A. Such an approach would draw support from the language of subsection (c) of Section 38A, authorizing the federal banking agencies to require reports from such a company for the purpose of (i) assessing the ability of the company to comply with subsection (b) of Section 38A and (ii) enforcing compliance with subsection (b).[43] For bank holding companies, the assessment would be facilitated of course by the fact that bank holding companies have long been subject to consolidated capital requirements. For savings and loan holding companies and companies controlling credit card banks, limited purpose trust companies and industrial loan companies, this assessment would be more challenging. As noted above, savings and loan holding companies have previously not been subject to consolidated capital rules, but as part of its implementation of the Basel III capital framework, the Board has proposed to extend the Basel III requirements to savings and loan holding companies as well as to all bank holding companies with more than $500 million in consolidated assets.[44] Both proposed extensions have met with strong objections from the affected industry sectors. In any event, companies that own or control credit card banks, limited purpose trust companies and industrial loan companies are not currently subject to consolidated capital rules and are not subject to the requirements of the Collins Amendment. These companies may nonetheless find that any assessment under rules to be issued under Section 38A could translate into *de facto* capital requirements for them, presumably on an institution by institution basis. This approach would be more akin to the historical approach taken by the OTS for savings and loan holding companies than to the approach currently proposed by the Board for savings and loan holding companies.

The reference to "ability" also suggests that the federal banking agencies might assess other aspects of the financial condition of a company, including most prominently its liquidity position, again perhaps translating the source-of-financial-strength requirement indirectly into a liquidity requirement for a company controlling an insured depository institution. The recent financial crisis provided several high-profile examples of financial institutions, such as Bear Stearns, Lehman Brothers and Washington Mutual, that were deemed to be "well capitalized" by applicable regulatory standards up to the very moment that they failed.[45] The proximate cause of their failures were liquidity problems related to market concerns about the integrity of their balance sheets. In the case of Bear Stearns and Lehman Brothers, these problems stemmed not from their depository operations which were quite small, but from the highly leveraged and short-term funded nature of their nondepository operations. Although the consolidated supervised entity program of the Securities and Exchange Commission (the "SEC") (applicable to such entities as Bear Stearns and Lehman Brothers) included both capital and liquidity elements, the liquidity elements proved to be insufficient to protect against the highly leveraged nature of their operations. Similar problems arose in the banking sector. The revelatory insight that the regulatory process had inadequately gauged liquidity risk in the system prompted many responses, including a new Basel Committee initiative on liquidity risk requirements[46] and the Dodd-Frank Act requirements for enhanced liquidity risk management for large bank holding companies and nonbank financial companies designated under Section 113 of the Dodd-Frank Act.[47] It would appear likely that reporting on various liquidity metrics will be required under any rules implementing Section 38A. Some observers have suggested the provisions of Section 38A might lead the FDIC to be more active generally in supervising the parent companies of insured entities such as industrial loan companies.[48]

It is likewise possible that the federal banking agencies might require an analysis of any contractual or other legal constraints on the ability of a company to make capital contributions to its insured depository subsidiary. The potential problems that contractual restrictions at the holding company level may present for the operation of the source-of-strength doctrine have been evident since the time of the first attempt by the Board to enforce a source-of-strength requirement in the *Hawkeye* case and have been reprised more recently in a judicial decision involving an analog of the source of strength.[49] Contractual restrictions on a holding company may act as a source of constraint on the source of strength. Similarly, corporate law considerations based on the fiduciary duty of directors may affect the operation of the source-of-financial-strength requirement as the Fifth Circuit decision in *MCorp* suggested. The language of Section 38A provides no indication that Congress intended the source-of-financial-strength requirement to override state corporate law requirements or private contractual provisions. If Congress intended the source-of-financial-strength requirement to override private contractual provisions in particular, one would have expected Congress to have spoken more clearly because of the concern with the retroactive application of a statutory provision negating pre-existing contract rights.[50] One may hope that the federal banking agencies will choose, as part of their rulemaking, to discuss these issues *en plein air.*

Other capital provisions in the Dodd-Frank Act appear to supplement the policies behind the source-of-strength doctrine. For example, Section 606(a) amends Section 4 of the BHC Act to require a financial holding company to be "well capitalized" and "well managed."[51] Under the Gramm-Leach-Bliley Act, a bank holding company could qualify as a financial holding company as long as each of its depository subsidiaries was "well capitalized" and "well managed."[52] The theory underlying this approach in Gramm-Leach-Bliley was that the well-capitalized and well-managed status of a depository subsidiary served to protect it from any potential risks that might arise from the expanded range of financial activities in which the other subsidiaries of the financial holding company might engage. Treasury's "Financial Regulatory Reform — A New Foundation" report issued in 2009 noted that many of the financial holding companies that were the most active in the volatile capital markets at the time of the financial crisis were not held to the highest consolidated regulatory capital standard.[53] The report accordingly recommended that financial holding companies themselves be required to meet a well-capitalized and well-managed status.[54] Well-capitalized status would presumably better position the financial holding company to serve as a source of strength to its bank subsidiaries and to its subsidiaries engaged in other financial activities such as in capital markets. The strengthening of regulatory capital requirements is of course now a pandemic exercise. The Basel III capital framework is specifically designed to strengthen the capital requirements for globally active banks and the Board has issued a proposal to implement the Basel III framework broadly in the U.S.

The approach taken in subsection 606(b) for the qualification of "well capitalized" and "well managed" for savings and loan holding companies differs somewhat from that of financial holding companies under the BHC Act.[55] Section 606(b) imposes the "well capitalized" and "well managed" criteria on savings and loan holding companies engaged in activities that are authorized for a financial holding company under Section 4(k) of the BHC Act. These criteria, however, do not apply to grandfathered savings and loan holding companies even if they engaged in Section 4(k) financial activities. Thus, there is not complete symmetry of treatment of bank holding companies and savings and loan holding companies with respect to financial holding company criteria.

PROVISIONS IN THE DODD-FRANK ACT RELATING TO FUNCTIONALLY REGULATED SUBSIDIARIES

The Gramm-Leach-Bliley Act introduced the term "functionally regulated subsidiary" to the lexicon of the BHC Act.[56] The term and the concepts underlying the term were integral to the approach adopted by the Gramm-Leach-Bliley Act, which was designed to permit the free affiliation of bank holding companies with companies engaged in other regulated financial activities, such as insurance underwriting and brokering and securities underwriting and dealing. As originally defined by the Gramm-Leach-Bliley Act, the term "functionally regulated subsidiary" included a registered broker-dealer, registered investment advisor with respect to its investment advisory activities, a registered investment company, an insurance company with respect to insurance activities subject to supervision by a state insurance regulator, and an entity subject to regulation by the Commodity Futures Trading Commission with respect to its commodity activities.[57] The Gramm-Leach-Bliley Act approach generally required that the Board defer to the functional regulator of such entities and placed restrictions on the ability of the Board to impose capital requirements or to take actions with respect to a functionally regulated subsidiary of a bank holding company.[58]

In the aftermath of the 2008 financial crisis, the Treasury Department concluded that the Gramm-Leach-Bliley Act restrictions impeded the Board's oversight of functionally regulated subsidiaries and recommended that various Gramm-Leach-Bliley Act provisions be revised or repealed.[59] The Board took a similar position in the legislative hearings on the financial reform legislation.[60] A version of financial reform legislation, S. 3217, approved by the Senate Committee on Banking, Housing, and Urban Affairs in April 2010 not only would have strengthened the Board's ability to examine functionally regulated subsidiaries of bank holding companies, but also would have repealed three key provisions of the BHC Act relating to functionally regulated subsidiaries, Section 5(c)(3), Section 5(c)(4), and Section 10A.[61]

Section 5(c)(3) provides that the Board may not by regulation, guideline, order or otherwise, impose any capital rule, standard or requirement on any functionally regulated subsidiary of a bank holding company that is in compliance with the applicable capital requirements of its federal regulatory authority or state insurance regulator.[62] Section 5(c)(4) provides that (i) the securities activities of a functionally regulated subsidiary of a depository institution shall be subject to regulation by the SEC and the relevant state securities authority to the same extent as if they were conducted in a nondepository institution subsidiary of a bank holding company; and (ii) the insurance agency and brokerage activities and activities as principal conducted in a functionally regulated subsidiary of a depository institution shall be subject to regulation by a state insurance authority to the same extent as if they were conducted in a nondepository institution subsidiary of a bank holding company.[63] The legislative history of the Gramm-Leach-Bliley Act indicates that the provisions in Section 5(c)(3) and 5(c)(4) were intended "to ensure that banking activities are regulated by bank regulators, securities activities are regulated by securities regulators, and insurance activities are regulated by insurance regulators."[64]

Section 10A(a) of the BHC Act as added by the Gramm-Leach-Bliley Act provided that the Board could not take action under or pursuant to the BHC Act or Section 8 of the FDIA against or with respect to a functionally regulated subsidiary of a bank holding company unless the action was necessary to prevent or address an unsafe or unsound practice or breach of fiduciary duty by the subsidiary that poses a material risk to the affiliated depository institution or the domestic or international payment system and the Board found that it was not reasonably possible to protect against the material risk by action directed at or against the affiliated depository institution.[65] Section 10A(b) further provided that the Board could not take any indirect action against or with respect to a functionally regulated subsidiary unless the Board could take the action directly under the standard set forth in Section 10A(a).[66]

The Dodd-Frank Act ultimately did include a repeal of Section 10A, but not of Section 5(c)(3) or Section 5(c)(4). The effect of the repeal of Section 10A is thus circumscribed by the fact that companion provisions in Section 5(c)(3) and Section 5(c)(4) have not been repealed. Restrictions on the ability of the Board to impose capital requirements or potentially other prudential requirements directly on functionally regulated subsidiaries have been retained in the BHC Act notwithstanding the repeal of Section 10A. In particular, a keystone provision to the deference system established by the Gramm-Leach-Bliley Act, Section 5(c)(3) relating to capital requirements for functionally regulated subsidiaries, survived the Dodd-Frank Act changes.

Even more significantly from the perspective of the source-of-strength doctrine, the Dodd-Frank Act does not repeal or amend the provisions of Section 5(g) of the BHC Act. Section 5(g)(1) contains an important restriction on the ability of the Board to require by regulation, order, or other action, a functionally regulated entity that is itself a bank holding company or a functionally regulated subsidiary of a bank holding company "to provide funds or other assets to a subsidiary depository institution of the bank holding company."[67] The restriction would be invoked if the state insurance authority or the SEC as the functional regulator of the entity determines in writing that:

> the holding company shall not provide such funds or assets because such action would have a material adverse effect on the financial condition of the insurance company or the broker, dealer, investment company, or investment adviser, as the case may be.[68]

If the state insurance authority or the SEC makes the above determination, the Board may (i) under Section 5(g)(3) order the bank holding company to divest the subsidiary depository institution and (ii) under Section 5(g)(4) restrict the holding company's operation of the subsidiary depository institution, including prohibiting transactions between the subsidiary depository institution and any affiliate, pending the divestiture. Thus, the state insurance authority or the SEC, as applicable, could impose a block on a transfer of funds or other assets from certain functionally regulated entities as part of any source-of-strength exercise involving a bank holding company.[69] This represents a potentially significant constraint on a source-of-strength exercise for a diversified bank holding company. As discussed below, this same constraint applies with respect to savings and loan holding companies with functionally regulated subsidiaries.

For historical reasons, HOLA itself was not amended by the Gramm-Leach-Bliley Act to incorporate restrictions on the supervision of functionally regulated subsidiaries. The Gramm-Leach-Bliley Act, however, did add a new Section 45 to the FDIA that extends the restrictions of Section 5(c) and Section 5(g) to:

> whatever authority a Federal banking agency might otherwise have under any statute or regulation…[to] impose capital requirements, or take any other direct or indirect action with respect to any functionally regulated affiliate of a depository institution, subject to the same standards and requirements as are applicable to the Board under [the relevant provisions of the BHC Act].[70]

The definition of the term "Federal banking agency" in the FDIA (as amended by the Dodd-Frank Act) specifies the Board as a federal banking agency and deletes the OTS as a federal banking agency.[71] Accordingly, the Board as successor to the OTS is subject to the same restrictions with respect to a functionally regulated subsidiary of a savings and loan holding under HOLA as it is with respect to a functionally regulated subsidiary of a bank holding company under the BHC Act.[72] Likewise, the FDIC and the OCC are subject to the same restrictions with respect to functionally regulated subsidiaries of companies that control exempt insured depository institutions, such as limited purpose trust companies or industrial loan companies. These restrictions presumably apply both to actions under the Board's source-of-strength requirement in Section 225.4(a) of Regulation Y and to actions under the source-of-financial-strength provision in Section 38A of the FDIA.

OTHER PROVISIONS IN THE DODD-FRANK ACT EXPRESSLY RELATING TO SOURCE OF STRENGTH

In addition to Section 616(d), there are two other provisions of the Dodd-Frank Act that expressly incorporate a source-of-strength requirement. Title I of the Dodd-Frank Act provides for the possible designation of nonbank financial companies as systemically important and as requiring consolidated supervision by the Board (whether or not the nonbank financial company owns or controls an insured depository institution).[73] Section 167(b) provides for the possible use of an intermediate holding company with respect to such a designated nonbank financial company.[74] Section 167(b)(1)(A) provides that the Board may require a designated nonbank financial company that engages in nonfinancial activities to establish and conduct all or a portion of its activities that are financial in nature or incidental thereto (other than "internal financial activities") in or through an intermediate holding company. Section 167(b)(1)(B) further provides that the Board shall require a nonbank financial company to establish such an intermediate holding company if the Board makes a determination that the establishment of an intermediate holding company is necessary: (i) to appropriately supervise the activities that are financial in nature or incidental thereto; or (ii) to ensure that the supervision by the Board does not extend to the commercial activities of the nonbank financial company.

Section 167(b) also provides the key elements of the intermediate holding company structure. First, to demarcate the scope of the activities required to be conducted in an intermediate holding company, Section 167(b)(2) provides that the financial activities subject to regulation under Section 167 do not include "internal financial activities," such as internal treasury, investment and employee benefit functions. Second, Section 167(b)(3) provides that any company that directly or indirectly controls an intermediate holding company established under Section 167 "shall serve as a source of strength to its subsidiary intermediate holding company." The source-of-strength requirement in Section 167(b)(3) applies even if the intermediate holding company does not own or control an insured depository institution. Third, Section 167(b)(4) provides that the Board may require reports from any company that controls an intermediate holding company solely for purposes of ensuring compliance with the provisions of Section 167, including assessing specifically the ability of the company that controls the intermediate holding company to serve as a source of financial strength. Fourth, Section 167(b)(5) provides that the Board may enforce the provisions of subsection (b) of Section 167 applicable to any company that controls an intermediate holding company through the use of the enforcement mechanisms under Section 8 of the FDIA. Section 167(c) provides that the Board shall promulgate regulations to establish criteria for the use of an intermediate holding company and any restrictions or limitations on transactions between an intermediate holding company and its nonbank financial company parent. The Board has not yet proposed any regulations relating to intermediate holding companies under Section 167.

Section 167(b) itself provides no definition of the term "source of strength" and so it is not clear whether the term "source of strength" in Section 167(b) should be read in a manner similar to the term "source-of-financial-strength" in Section 616(d) at least in respect of financial resources. In one respect, Section 167(b)(3) is broader than Section 616(d) because it requires any company that directly or indirectly controls an intermediate holding company to act as a source of strength to the intermediate holding company and presumably thereby to the subsidiaries of the intermediate holding companies. In that respect, the policy objective of Section 167(b)(3) is different from the policy objective reflected in Section 225.4(a)(1) and in the Board's 1987 policy statement. The latter is based in large measure on the federally insured status of the bank subsidiary. The source-of-strength requirement under Section 167(b) on the other hand applies even if the intermediate holding company does not own or control an insured depository institution. The policy supporting the source-of-strength requirement in Section 167(b) relates instead to the systemically important character of the financial activities conducted in the intermediate holding company or in the subsidiaries of that company. To mitigate the risks that might be presented by financial difficulty at the intermediate holding company or at its subsidiaries, the companies controlling the intermediate holding company would presumably be required to provide financial assistance to the intermediate holding company. Precisely what level of financial difficulty at the intermediate holding company or its subsidiaries will trigger the source-of-strength requirement is not clear. The Board has proposed rules to implement the enhanced prudential and early remediation requirements for bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated under Section 113 of the Dodd-Frank Act.[75] The minimum requirements of the capital, liquidity and early remediation components of these rules as applied to the intermediate holding company would likely provide a potential baseline for support levels required from a company controlling an intermediate holding company.[76] If the Board ultimately issues rules under Section 167(b), the scope of the source-of-strength requirement applicable to an intermediate holding company might be further clarified.

The situation could become more complicated if the intermediate holding company also owns or controls an insured depository institution. In that case, the appropriate federal banking agency would also appear to have authority to apply the requirements of Section 38A of the FDIA to the intermediate holding company and any company that directly or indirectly controls the intermediate holding company.[77] The overlap of source-of-strength regimes could theoretically present a risk of conflict between the Board and the other appropriate federal banking agency, but the priority for both the Board and any other applicable federal banking agency would presumably be to require that financial support be provided, if necessary, first to any insured depository institution controlled by the intermediate holding company.

Paralleling the approach in Section 167(b), Section 626 of the Dodd-Frank Act adds a new Section 10A to HOLA, providing for the possible use of an intermediate holding company with respect to a grandfathered unitary savings and loan holding company.[78] Like Section 167(b), Section 10A(b)(1) provides that if a grandfathered unitary savings and loan holding company engages in activities other than financial activities, the Board may require the company to establish an intermediate holding company to conduct all or a portion of its financial activities (other than internal financial activities). The Board must require the company to establish such an intermediate holding company if it determines that the establishment is necessary to appropriately supervise the activities of the company that are financial activities or to ensure that supervision by the Board does not extend to the activities that are not financial activities. Like Section 167(b), Section 10A(b)(3) provides that a grandfathered unitary savings and loan holding company that directly or indirectly controls an intermediate holding company "shall serve as a source of strength to its intermediate holding company." Section 10A(b)(4) also provides that the Board may examine and require reports from the grandfathered unitary savings and loan holding company solely for the purposes of ensuring compliance with Section 10A, including assessing the ability of the company to serve as a source of strength to the intermediary holding company. Section 10A(b)(5), like Section 167(b), provides that the Board may enforce compliance with the provisions of Section 10A applicable to any company that controls an intermediate holding company through the use of the enforcement mechanisms under Section 8 of the FDIA. Finally, Section 10A(c) provides that the Board shall promulgate regulations to establish the criteria for use of an intermediate holding company and any restrictions or limitations on transactions between an intermediate holding company and its parent company or affiliates. The Board has not as yet initiated any rulemaking for the use of intermediate holding companies by grandfathered unitary savings and loan holding companies.

If the Board ultimately authorizes the use of an intermediate holding company by a grandfathered unitary savings and loan holding company, there will be at least a partial overlap of the source-of-strength regime under Section 10A of HOLA and the source-of-financial-strength regime under Section 38A of the FDIA. Under Section 10A of HOLA, the grandfathered unitary savings and bank holding company that controls the intermediate holding company must serve as a source of strength to the intermediate holding company. Under Section 38A of the FDIA, the intermediate holding company and any company that directly or indirectly controls the intermediate holding company must also serve as a source of financial strength to the depository institution subsidiary. Similar to the observation made above with respect to an intermediate holding company established under Section 167(b), the source-of-strength requirement under Section 10A is broader than the source-of-financial-strength requirement under Section 38A. The latter extends only to the insured depository institution subsidiary of the intermediate holding company whereas the source-of-strength requirement under Section 10A may extend in effect to all the subsidiaries of the intermediate holding company. A grandfathered unitary savings and loan company with significant subsidiaries engaged in financial activities might prefer *ceteris paribus* to avoid an intermediate holding company structure because it would thereby become subject to a source-of-strength requirement for all the subsidiaries under the intermediate holding company. In the absence of such an intermediate holding company, the grandfathered unitary savings and loan would be subject to a source-of-strength requirement only for its insured depository institution subsidiary.

TREATMENT OF SOURCE-OF-STRENGTH REQUIREMENTS UNDER THE BANKRUPTCY CODE

The treatment of a source-of-strength requirement in the event of the bankruptcy of a company subject to the requirement is a topic of recurring interest. The resolution plan or living will requirement in Section 165(d) of the Dodd-Frank Act provides the current occasion to evaluate the treatment of a source-of-strength or source-of-financial-strength requirement under the Bankruptcy Code. Section 165(d) requires all bank holding companies with $50 billion or more in total consolidated assets and all nonbank financial companies designated under Section 113 to develop a resolution plan specifying how it could be resolved in an orderly fashion under the Bankruptcy Code.[79] Preparing such a plan is a complex process involving a wide range of legal, operational and financial considerations.[80] The possible treatment of any source-of-strength requirement should be a relevant factor in assessing a resolution plan under the Bankruptcy Code.

As discussed in Part I of this article, special provision has been made in the Bankruptcy Code for the treatment of a "commitment" made to a federal depository institutions regulatory agency "to maintain the capital of an insured depository institution."[81] Section 365(o) of the Bankruptcy Code provides that in a Chapter 11 case such a commitment will be deemed to have been assumed and any deficit under the commitment must be immediately cured.[82] The courts have held that the assumption of the capital maintenance agreement and the cure of any deficit thereunder are prerequisites to reorganization under Chapter 11. If these prerequisites are not met, the debtor must convert the case into a case under Chapter 7.[83] Section 507(a)(9) provides that a claim based on such a commitment will be entitled to priority ahead of other general unsecured creditors in the bankruptcy case.[84]

As discussed in Part I of this article, these provisions were added to the Bankruptcy Code in 1990 to clarify the treatment of such "commitments" in bankruptcy cases. Instead, the provisions have proven to be fertile grounds for contest. Two recent federal court decisions highlight the ambiguities surrounding the interpretation of these provisions. In September 2012 the Sixth Circuit Court of Appeals ruled that a stipulated cease and desist order entered into by the OTS and AmTrust Financial Corporation ("AmTrust") did not constitute a "commitment" by AmTrust to maintain the capital of its bank subsidiary, AmTrust Bank, for purposes of Section 365(o) of the Bankruptcy Code.[85] In November 2008 the OTS had issued an order to cease and desist on stipulation with AmTrust Bank that required AmTrust Bank to achieve and maintain certain specified capital ratios. At the same time the OTS issued an order to cease and desist on stipulation with AmTrust that provided *inter alia* that:

> [t]he Board [of AmTrust] shall ensure that [AmTrust Bank] complies with all of the terms of its Order to Cease and Desist issued by the OTS on November 19, 2008.[86]

In its subsequent Chapter 11 case, AmTrust argued that the order to cease and desist did not constitute a commitment by AmTrust to maintain the capital levels of AmTrust Bank for purposes of Section 365(o). The FDIC as receiver for AmTrust Bank argued that by agreeing to enter into the stipulated order to cease and desist, containing the language quoted above, AmTrust had made a commitment to maintain the capital levels of AmTrust Bank and was obligated under Section 365(o) to cure a capital deficit at AmTrust Bank of approximately $1 billion. The district court rejected the FDIC's position.[87]

On appeal the Sixth Circuit agreed with the district court that the order to cease and desist was ambiguous on its face because the requirement that AmTrust's board of directors ensure that AmTrust Bank complied with its own cease and desist order could be read as establishing either an oversight role or a capital commitment role for AmTrust. Because of the ambiguity, the district court relied on extrinsic evidence in reaching its conclusion that the order to cease and desist did not constitute a commitment to maintain the capital of AmTrust Bank. The Sixth Circuit reviewed the extrinsic evidence, including evidence suggesting that neither the OTS nor AmTrust regarded the language in the order to cease and desist as obligating AmTrust to contribute capital to AmTrust Bank, and concluded that the bulk of the extrinsic evidence favored the "oversight" rather than the capital commitment reading of the order to cease and desist.[88]

The Sixth Circuit ruling in *AmTrust* may have implications for the pending appeal in *In re Colonial BancGroup* discussed in Part I of this article.[89] The facts involved in the *Colonial BancGroup* case are generally similar in their broad outline to those in the *AmTrust* case. In June 2009 Colonial Bank, a subsidiary of Colonial BancGroup, entered into a consent cease and desist order with the FDIC and Alabama State Banking Department, requiring Colonial Bank to achieve certain specified capital ratios by September 30, 2009. In July 2009, Colonial BancGroup entered into a consent cease and desist order with the Board and the Alabama State Banking Department. The consent order contained two provisions that expressly referred to a source-of-strength requirement. Section 1 of the consent order, entitled "Source of Strength," provided as follows:

> The board of directors of BancGroup shall take appropriate steps to ensure that the Bank complies with the Order to Cease and Desist entered into with the Federal Deposit Insurance Corporation (the "FDIC") and the Superintendent effective as of June 15, 2009, and any other supervisory action taken by the Bank's federal or state regulators.[90]

Section 2 of the consent order, entitled "Capital Plan," required Colonial BancGroup to submit a plan to maintain sufficient capital at Colonial BancGroup and Colonial Bank. Under the terms of Section 2, the plan was to "address" and "consider" among other factors:

> the requirements of section 225.4(a) of Regulation Y of the Board of Governors (12 C.F.R. § 225.4(a)) that BancGroup serve as a source of strength to [Colonial Bank].[91]

Based on the consent cease and desist order and other regulatory agreements, the FDIC as receiver for Colonial Bank sought to require Colonial Banc-

Group either to immediately cure the deficit under the alleged commitment to maintain the capital of Colonial Bank or to convert the case to a case under Chapter 7 of the Bankruptcy Code.

The bankruptcy court, citing the Fifth Circuit decision in *MCorp*, observed that the source-of-strength doctrine does not require a bank holding company to make capital contributions to its subsidiaries.[92] The bankruptcy court then proceeded to analyze the specific language in the consent order and stated:

> The language is broad and general and requires only that the Debtor "assist" the Bank. The language does not specify any particular method of assistance or prescribe specific steps that the Debtor must take. The language does not dictate what financial and managerial resources the Debtor must utilize. Nor does it require the Debtor to serve as a guarantor of the capital ratios or to pledge any assets to secure any capital deficiency. Most importantly, the language does not require the Debtor to make a capital infusion, in any amount, in the Bank.[93]

In the course of a discursive opinion, the bankruptcy court concluded that both the "unambiguous" language of the regulatory documents and the intent of the parties evinced that Colonial BancGroup had not made a commitment to maintain the capital of Colonial Bank within the meaning of Section 365(o) of the Bankruptcy Code.[94]

The FDIC has taken an appeal of the bankruptcy court decision to a federal district court and that appeal is still pending. The holding of the Sixth Circuit in the *AmTrust* case provides further support for the position of Colonial BancGroup. The holding in the *AmTrust* case does not relate to the source-of-strength doctrine as such because AmTrust was not a bank holding company. Nonetheless, the interpretation of the language of the order to cease and desist by the Sixth Circuit for purposes of Section 365(o) is relevant to the interpretation of the language of the consent order with Colonial BancGroup for the purposes of Section 365(o). The Sixth Circuit concluded that the language to the effect that the board of AmTrust "shall ensure" that AmTrust Bank complied with its own cease and desist order did not unambiguously commit AmTrust to contribute capital to AmTrust Bank.[95] The comparable language in the Colonial BancGroup consent order is to the effect that the board of directors of Colonial BancGroup "shall take appropriate steps to ensure" that Colonial Bank complied with its own cease and desist order. This language appears no stronger on its face than the language in the AmTrust order and will likely on appeal be found not to constitute an unambiguous commitment to maintain capital within the meaning of Section 365(o).

It is worth comparing the language in the Colonial BancGroup consent order with the standard language that the Board now uses in its consent orders and written agreements. The standard formulation in a separate source-of-strength section in a consent order or written agreement reads as follows:

> The board of directors of [the bank holding company] shall take appropriate steps to fully utilize [the bank holding company's] financial and managerial resources, pursuant to section 38A of the [FDIA]… and section 225.4 of Regulation Y…to serve as a source of strength to the [b]ank including, but not limited to, taking steps to ensure that the [b]ank complies with the [formal agreement] or [consent order] entered into with the [primary federal bank regulator] on [date], and any other supervisory action taken by the Bank's federal or state regulator.

Other than the expanded language relating to taking "appropriate steps to fully utilize" the holding company's financial and managerial resources to serve as a source of strength to the bank, this language is not much advanced over the language in the *Colonial BancGroup* case, which the bankruptcy court found not to constitute a commitment to maintain the capital of a subsidiary. There is reason to believe that a bankruptcy court would find that the standard language does not meet the requirements of Section 365(o).

If the Board wishes to obtain the advantage of preferred treatment under Section 365(o) or Section 507(a)(9), the Board would probably have to include express language committing the bank holding company to make a capital contribution to the bank subsidiary. Existing case law supports the proposition that a written agreement or undertaking with a federal banking agency to maintain the capital of an insured depository subsidiary at or above a specified ratio or at or above a level set in an agency's capital rules would be viewed as a commitment to maintain capital within the meaning of Section 365(o).[96] Even more clearly, providing a guarantee of an insured depository subsidiary's capital restoration plan pursuant to Section 38 of the FDIA would be viewed as a commitment to maintain capital within the meaning of Section 365(o).[97]

It may be the case that the Board does not intend the source-of-strength provisions in its standard cease and desist order or written agreement to constitute a commitment for purposes of Section 365(o) or Section 507(a)(9) and that it expects to achieve the status of a commitment for purposes of these sections only when the bank holding company provides a guarantee of a capital restoration plan under Section 38 of the FDIA or is made subject to a consent cease and desist order that directly commits the bank holding company to make a specified capital contribution to its bank subsidiary. Such a conclusion would be consistent with the theory that the broad prophylactic benefit that the Board derives from the source-of-strength doctrine is a heightened oversight and a more risk-adverse approach to the operation of insured subsidiaries by the management of bank holding companies. Under this theory the prospect of a future source-of-strength demand induces management of the holding company to supervise the depository institution more carefully and so diminishes the risk that an actual demand under the source-of-strength requirement need ultimately be made. As discussed in Part I of this Article, this is certainly one of the benefits of the source-of-strength doctrine that various commentators have hypothesized.[98] In actuality, however, there are more important and immediate regulatory concerns that would induce management of a bank holding company to supervise the affairs of an insured subsidiary carefully, such as the consequences under Section 4(m) of the BHC Act if a depository institution subsidiary fails to retain its well-capitalized or well-managed status.[99] The adverse consequences under Section 4(m) would likely arise well before an insured depository institution began to approach its minimum capital requirements. The relative importance of any hypothesized prophylactic effect from the source-of-strength doctrine has been diminished by intervening regulatory developments since the time that the expanded source-of-strength doctrine was first articulated in 1987. This suggests that the residual importance of the source-of-strength doctrine continues to lie in its application to *in extremis* situations such as *Hawkeye* and *MCorp*.

TREATMENT OF SOURCE-OF-STRENGTH REQUIREMENTS UNDER TITLE II

Title II of the Dodd-Frank Act creates a new statutory regime, the Orderly Liquidation Authority, which is intended to permit the orderly liquidation of a financial company whose failure could adversely affect the financial stability of the United States. If invoked, the Orderly Liquidation Authority under Title II would be used in lieu of the Bankruptcy Code to resolve the troubled financial company. The Orderly Liquidation Authority is modeled upon the receivership provisions of the FDIA applicable to insured depository institutions. It provides for the appointment of the FDIC as the receiver for the troubled financial company (referred to as a "covered financial company") if certain systemic findings are made with respect to the company. It further provides for the FDIC as receiver to wind down the covered financial institution in an orderly manner using many of the special powers and procedures that historically have applied to the liquidation of insured depository institutions under the FDIA.[100]

Although Title II is modeled upon the receivership provisions of the FDIA, it does incorporate a few select elements from the Bankruptcy Code. It does not, however, incorporate any provision comparable to Section 365(o) or Section 507(a)(9). Title II is not designed to provide an option for the reorganization of a covered financial company comparable to that in a Chapter 11 case. Accordingly, there was no occasion for the drafters of Title II to provide for a requirement like that contained in Section 365(o). Title II does contain a priority section that borrows elements from both the FDIA and the Bankruptcy Code.[101] It does not, however, provide an express priority for a commitment to maintain the capital of an insured depository institution like Section 507(a)(9).

The priority scheme in Title II provides a first priority for "[a]dministrative expenses of the receiver" and a second priority for "[a]ny amounts owed to the United States."[102] To determine how a source-of-financial-strength requirement would affect a Title II orderly liquidation it is necessary to triangulate the analysis. If the FDIC *in its capacity as receiver for the insured depository subsidiary* were to assert a source-of-financial-strength claim against the covered financial company, the claim would not appear to represent either an administrative expense of the receiver or an amount owed to the United States.[103] The answer would appear to be the same if the FDIC *in its corporate capacity* sought to enforce a claim under a rule adopted under Section 38A or under a guarantee of a capital restoration plan under Section 38.[104] A claim by the FDIC as receiver for an insured depository institution or in its corporate capacity based either on a source-of-financial-strength requirement or a commitment to maintain the capital of an insured depository institution would appear to fall into the category of "any other general or senior liability" of the covered company.[105] In the case of a regulatory agreement that would constitute a "commitment" to maintain capital, the FDIC as receiver for the insured depository institution would fare less well under Title II than it would if the covered financial company had been resolved in a Chapter 11 or Chapter 7 case. However, the FDIC *in its capacity as receiver of the covered financial company* and organizer of any bridge holding company may be able to avoid these interpretive issues by treating a capital contribution to the insured depository institution as a necessary expense to preserve the value of the depository institution subsidiary. The FDIC as receiver of the covered financial company could then argue that the amount of the capital contribution was either an administrative expense of the receiver or an amount owed to the United States if the FDIC provides funds necessary to make the capital contribution.[106]

Even as it begins to contemplate these prospects, the FDIC will find itself in a conflict of interest as the receiver of the covered financial institution and as the receiver or potential receiver of its insured depository institution subsidiary.[107] The dialectic seen in the *Colonial BancGroup* and *AmTrust* cases will be missing because the FDIC will sit on both sides of the table. The significance of the underlying point is that the creation (either explicitly or implicitly) of a priority for a source-of-financial-strength requirement in a Title II proceeding will likely affect how losses will be apportioned in the consolidated entity. A priority for a source-of-financial-strength requirement in a Title II proceeding will mean that the uninsured depositors, unsecured creditors and contingent claimants of an undercapitalized depository subsidiary will be protected at the expense of even deeper discounts on the creditors of the covered financial company.

The issue discussed above is suggestive of a larger set of conflicts that the FDIC will encounter as receiver for a covered financial company and as a receiver or potential receiver of its insured depository subsidiary. One can envision a situation of a covered financial company that owns both a systemically important insured depository institution and a systemically important nonbank subsidiary, such as a broker-dealer. In such a case, can the FDIC as receiver of the covered financial company or as organizer of a bridge holding company provide support to the insured depository institution in preference over the broker-dealer subsidiary if the latter presents the same degree of risk to U.S. financial stability as the insured depository institution?[108] Can the FDIC as receiver under Title II choose to provide greater support at the margin to the insured depository institution simply to limit the exposure of the Deposit Insurance Fund under the FDIA?[109] What processes will the FDIC implement to serve as a check on the conflicts that will invariably arise when it is functioning in the dual capacities of receiver for a covered financial company and receiver or potential receiver for its insured depository institution subsidiary? Title II directs the FDIC to issue such rules as the FDIC considers necessary or appropriate to implement Title II, including rules to address the potential for conflicts of interest between or among individual receiverships established under Title II or under the FDIA.[110] The FDIC has issued a set of regulations under Title II, but has not yet proposed any regulations addressing potential conflicts of interest.[111]

The ultimate parties in interest on the issue of how the source-of-financial-strength requirement would be applied in a Title II proceeding are the insured depository institutions that are assessable under the FDIA to support the Deposit Insurance Fund and the financial companies with total consolidated assets of $50 billion or more that are assessable under Title II to support the Orderly Liquidation Fund.[112] The application of a source-of-financial-strength requirement in a Title II proceeding may determine whether the Deposit Insurance Fund incurs losses with respect to the insured depository institution subsidiary of a covered financial company or whether losses that the Deposit Insurance Fund might otherwise have borne will instead be borne by the covered financial company and ultimately by the financial companies that would be assessed under Title II to support the Orderly Liquidation Fund. The interaction of the source-of-financial-strength requirement and the Title II Orderly Liquidation Authority provides new-found significance to the old source-of-strength doctrine, a significance that likely exceeds any of the other legacies of the old doctrine.

THE NEW ADVENTURES OF AN OLD DOCTRINE

Part I of this article surveyed the practices and controversies surrounding the original and "expanded" source-of-strength doctrine as reflected in Section 225.4(a)(1) of Regulation Y, the Board's 1987 policy statement, and the Board's subsequent enforcement orders. Part I also discussed the lingering question of the validity of the expanded doctrine and the consequent creation of other statutory schemes (the cross-guarantee provision and the guarantee of a capital restoration plan provision) to complement or supplement the source-of-strength doctrine.

In the wake of the financial crisis, Congress has chosen to codify a source-of-financial-strength doctrine in the FDIA. It too is an "expanded" doctrine in at least one sense: it applies not only to all bank holding companies but also to all other companies that directly or indirectly control an insured depository institution. The other bounds of the source-of-financial-strength requirement are still to be determined, presumably by the rules that the federal banking agencies are directed to issue under Section 38A. At a minimum, one might expect the federal banking agencies to include in their rules under Section 38A the well-remembered elements of the source-of-strength doctrine from the Board's 1987 policy statement. This would include elements of both ability (such as the financial flexibility and capital-raising capacity of the holding company) and action (such as the direct contribution of funds or other assets by a holding company to the insured depository subsidiary when directed). One might also expect the rules to address any reporting requirements that might be imposed upon companies that control insured depository institutions. The federal banking agencies may also choose to address certain of the legal issues relating to the ability of a holding company to meet the requirements of Section 38A. One should not be disappointed, however, if the federal banking agencies choose not to address the broader policy and legal issues presented by the application of the source-of-financial-strength doctrine in a Title II proceeding. That is one new adventure that the federal banking agencies may not yet want to anticipate.

NOTES

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010). Except as otherwise indicated, citations to sections of the Dodd-Frank Act contained in these footnotes are to the sections of the United States Code in which the Dodd-Frank Act sections are codified.

[2] 12 U.S.C. § 1831o-1 (2011).

[3] 12 U.S.C. § 1844(b); 12 U.S.C. § 1467a(g)(1) (2011).

[4] 12 U.S.C. § 1843(l)(1)(C) (2011).

[5] 12 U.S.C. § 1467a(c)(2)(H) (2011).

[6] 12 U.S.C. § 1844(c)(1) (2011).

[7] 12 U.S.C. § 1844(c)(2) (2011).

[8] 12 U.S.C. § 1467a(b)(2) (2011).

[9] Pub. L. No. 106-102, § 113, 113 Stat. 1338, 1369 (1999) (adding § 10A to the BHC Act); Pub. L. No. 111-203, § 604(c)(2), 124 Stat. at 1601 (2010) (repealing § 10A).

[10] 12 U.S.C. § 1844(c)(3) (2011).

[11] 12 U.S.C. § 1844(g) (2011).

[12] 12 U.S.C. § 1831v (2011).

[13] 12 U.S.C. § 5367(b) (2011). Under § 113, the Financial Stability Oversight Council is authorized to designate a nonbank financial company for comprehensive supervision by the Board if the Council determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities, could pose a threat to the financial stability of the United States. 12 U.S.C. § 5323(a)(1)(2011). A designated nonbank financial company would become subject to various enhanced prudential standards specified in § 165 of the Dodd-Frank Act. 12 U.S.C. § 5365 (2011).

[14] 12 U.S.C. § 5367(b)(3) (2011).

[15] 12 U.S.C. § 1467b (2011).

[16] 12 U.S.C. § 1467b(b)(3) (2011).

[17] 12 U.S.C. § 5365(d) (2011).

[18] For a detailed discussion of the Title II Orderly Liquidation Authority, *see* Paul L. Lee, *The Dodd-Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique – Part I*, 128 Banking L. J. 771 (2011) & *Part II*, 128 Banking L. J. 867 (2011).

[19] 11 U.S.C. §§ 365(o) & 507(a)(9) (2011).

[20] 12 U.S.C. § 1831o-1(a). Subsection (a) of § 38A refers to a "depository institution." Subsections (b), (c) and (e) refer to an "insured depository institution." The omission of the word "insured" in subsection (a) appears to be inadvertent.

[21] 12 U.S.C. § 1831o-1(b) (2011).

[22] Qualifying credit card banks, limited purpose trust companies and industrial loan companies are exempt from the definition of "bank" in the BHC Act. *See* 12 U.S.C. § 1841(c)(2)(D) (limited purpose trust company), (F) (credit card bank), & (H) (industrial loan company). The Dodd-Frank Act added a similar exemption to HOLA for a savings association that meets the qualifications for a limited purpose trust company under the BHC Act. *See* 12 U.S.C. § 1467a(a)(1) (D)(ii)(II) (2011).

[23] The OCC has an existing practice of requiring companies that are chartering or acquiring control of limited purpose trust companies or credit card banks under the National Bank Act to enter into a capital and liquidity support agreement. This agreement specifically provides that the holding company or companies agree that they will contribute sufficient capital to the bank to bring the bank into compliance with any minimum or other additional capital requirements that the OCC has made applicable to the bank. The agreement also provides that the holding company "will provide such financial support" as may be required to ensure that the bank remains in compliance with any liquidity requirements that the OCC has made applicable to the bank. The agreement provides that it will survive any appointment of a receiver for the bank. *See*, *e.g.*, OCC Conditional Approval Letter #954, dated May 7, 2010, to John P.C. Duncan relating to charter application for Neuberger Berman Trust Company National Association and Neuberger Berman Trust Company of Delaware, National Association; OCC Conditional Approval Letter #934, dated Nov. 19, 2009, to Bartholomew A. Battista relating to Change in Bank Control notice by BlackRock, Inc. to acquire Barclays Global Investors, National Association; OCC Corporate Decision Letter 2004-2, dated Oct. 29, 2003, to Franca Harris Gutierrez relating to Change in Bank Control Act notice by Lehman Brothers Holding Inc. to acquire Neuberger Berman Trust Company, National Association.

The FDIC has used capital maintenance agreements in the past when granting insurance coverage to industrial loan companies being chartered by corporations. These agreements commit the parent companies to maintaining the capital levels in the industrial loan company and specifically obligate the parent companies to "immediately contribute sufficient additional capital to ensure that the [m]inimum [c]apital [r]equirements of the [industrial loan company] are met." The FDIC agreement also recites that the obligations under the agreement are "commitments to maintain the capital" of the industrial loan company and that if a bankruptcy petition were to be filed by or against a parent company, the parent company would use its best efforts to cause the obligations under the agreement to be paid as an administrative expense of the debtor pursuant to Section 507(a)(1) of the Bankruptcy Code. *See, e.g.*, Capital Maintenance Agreement, dated as of Nov. 15, 2006, by and among the FDIC, GMAC LLC, IB Finance Holding Company, and GMAC Bank, *available at* www.fdic.gov/regulations/laws/ bankdecisions/other/GMACCapital.pdf. One court has declined to accept the proposition that a commitment of this type should be treated as an administrative expense as opposed to the priority specified in § 507(a)(9) of the Bankruptcy Code. *See Wolkowitz v. FDIC (In re Imperial Credit)*, 527 F.3d 959 (9th Cir. 2008).

[24] 12 U.S.C. § 1831o-1(c) (2011).

[25] *See* Joe Adler, *Bank Parents About to Receive a Big 'Wake-Up Call'*, AM. BANKER, Aug. 20, 2012.

[26] 12 U.S.C. § 1831o-1(e) (2011).

[27] 12 C.F.R. § 225.4(a)(1) (2011).

[28] 12 U.S.C. § 1831o-1(e) (2011).

[29] *See* Policy Statement on the Responsibility of Bank Holding Companies to Act as Sources of Strength to their Subsidiary Banks, 52 Fed. Reg. 15707 (Apr. 30, 1987).

[30] *Id*. at 15707.

[31] *Id*. at 15708.

[32] *See* Sections 365(o) and 507(a)(9) of the Bankruptcy Code refer to a "commitment by a debtor" to a federal depository institutions regulatory agency to maintain the capital of an insured depository institution. An order from a federal regulatory agency to a holding company to maintain the capital of its depository institution subsidiary would not constitute a "commitment" by the debtor unless the debtor consents to the order through a stipulation or otherwise. The application of these provisions is discussed in detail *infra* at text accompanying notes 79-97.

[33] 52 Fed. Reg. at 15707.

[34] 12 U.S.C. § 1844(b) (2011). Under the amendment made by § 616(a), the Board in establishing capital requirements shall also

> seek to make such requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.

Id.

[35] 12 U.S.C. § 1467a(g)(1) (2011).

[36] For a discussion of the approach to capital used by the OTS, see Paul L. Lee, *Savings and Loan Holding Companies after the Dodd-Frank Act: An Endangered Species? –Part I*, 129 BANKING LAW J. 147, 158 & n. 34 & 35.

[37] *See Strengthening and Streamlining Prudential Bank Supervision–Part I: Testimony of John C. Dugan, Comptroller of the Currency, before the U.S. S. Comm. on Banking, Housing, and Urban Affairs*, 111th Congress, 2nd session, 7 (Aug. 4, 2009).

[38] The Senate Committee Report accompanying § 3217 describes the intent as follows:

> This section provides the Federal Reserve with the same authority to prescribe capital standards for savings and loan holding companies that it currently has for bank holding companies. It is the intent of the Committee that in issuing regulations relating to capital requirements of bank holding companies and savings and loan holding companies under this section, the Federal Reserve should take into account the regulatory accounting practices and procedures applicable to, and capital structure of, holding companies that are insurance companies (including mutuals and fraternals), or have subsidiaries that are insurance companies.

S. Rep. No. 111-176, at 89 (2010).

[39] 12 U.S.C. § 5371 (2011).

[40] 12 U.S.C. § 5371(b)(4)(D) (2011).

[41] *See* Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor, 76 Fed. Reg. 37,620, 37,626 (June 28, 2011) (codified at 12 C.F.R. pt. 208, App. A).

[42] *See* Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor, 76 Fed. Reg. 82,317 (Dec. 30, 2010) (proposed rule).

[43] 12 U.S.C. § 1831o-1(c) (2011).

[44] *See* Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012).

[45] *See, e.g.*, *Testimony Concerning Recent Events in the Credit Markets: Hearing before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong. 1 (2008) (statement of Christopher Cox, Chairman, U.S. Securities and Exchange Commission) (noting that Bear Stearns was "well-capitalized" in March 2008); *Wall Street and the Financial Crisis: Hearing before the S. Permanent Subcomm. on Investigations*, 111th Cong. 4 (2010) (statement of John Bowman, Acting Director, Office of Thrift Supervision) (noting that Washington Mutual remained "well-capitalized" in September 2008).

[46] Basel Committee on Bank Supervision, *Basel III: International Framework for Liquidity Risk Measurement, Standards, and Monitoring* (Dec. 20, 2010), *available at* www.bis.org/pub/bcbs188.htm.

[47] 12 U.S.C. § 5365(b)(1)(A)(ii) (2011). The Board has proposed rules relating to liquidity risk management under this Dodd-Frank Act provision. *See* Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (Jan. 5, 2012).

[48] *See* Adler, *supra* note 25, at 3.

[49] *See Fed Disciplines Financially Strapped BHC for Failure to Bail Out Ailing Subsidiary*, 48 Banking Rep. (BNA) 297 (Feb. 16, 1987) (reporting that *Hawkeye* had asserted that the covenants in a recently completed restructuring of its debt

prevented it from contributing further capital to the ailing subsidiary). *See also In re AmTrust Financial Corporation*, 2012 WL 4039755 (6th Cir. 2012) (noting that the directors of AmTrust were concerned that AmTrust might be violating covenants in its debt securities if it sold assets and transferred the proceeds to its bank subsidiary to comply with an OTS cease and desist order).

50 *Cf. United States v. Security Industrial Bank*, 459 U.S. 70, 81 (1982) ("No bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress.").

51 12 U.S.C. § 1843(l)(1)(C) (2011).

52 12 U.S.C. § 1843(l)(1)(A) & (B). In addition, each insured depository institution subsidiary of the holding company has to have at least a satisfactory Community Reinvestment Act rating. 12 U.S.C. § 1843(l)(2) (2011).

53 *See* U.S. Dep't of the Treasury, Financial Regulatory reform, A New Foundation: Rebuilding Financial Supervision and regulation 30 (June 2009).

54 *Id*.

55 12 U.S.C. § 1467a(c)(2)(H).

56 Pub. L. No. 106-102. § 111, 113 Stat. at 1366 (codified at 12 U.S.C. § 1844(c)(5)).

57 *Id.*

58 12 U.S.C. §§ 1844(c)(1)-(5) & 1844(g).

59 Financial Regulatory reform, *supra* note 53, at 11. The Dodd-Frank Act amended the definition to include additional entities regulated by the Commodity Futures Trading Commission. Pub. L. No. 111-203, § 604, 124 Stat. at 1601 (2010).

60 *See Strengthening and Streamlining Prudential Bank Supervision – Part I: Testimony of Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System, before the U.S. Senate Committee on Banking, Housing and Urban Affairs*, 111th Congress, 2nd session, 13 (Aug. 4, 2009).

61 S. 3217, § 604(c), 111th Cong. 2nd Sess. (2010).

62 12 U.S.C. § 1844(c)(3) (2011).

63 12 U.S.C. § 1844(c)(4) (2011).

64 H.R. Rep. No. 106-434, 157 (1999).

65 Pub. L. No. 106-102, § 113, 113 Stat. at 1368-69 (1999).

66 *Id*.

67 12 U.S.C. § 1844(g)(1) (2011).

68 12 U.S.C. § 1844(g)(2) (2011).

69 12 U.S.C. § 1844(g)(3) & (4) (2011).

70 12 U.S.C. § 1831v (2011).

71 12 U.S.C. § 1813(q) (2011).

72 The legislative history of this provision confirms this outcome. The Joint

Explanatory Statement of the Committee of Conference for the Gramm-Leach-Bliley Act explains the restrictions with respect to functionally regulated entities as follows:

> The Board is prohibited from requiring a broker-dealer or insurance company that is a bank holding company to infuse funds into a depository institution if the company's functional regulator determines, in writing, such action would have a material adverse effect on the broker-dealer or insurance company. If the functional regulatory makes such a determination, the Board may require the holding company to divest its depository institution. All the Federal banking agencies are subject to the same limits on reports, examinations and capital requirements for functionally regulated affiliates which apply to the Board.

145 Cong. Rec. H 11255, H 11295 (Nov. 2, 1999).

[73] 12 U.S.C. § 5323 (2011).

[74] 12 U.S.C. § 5367(b) (2011).

[75] Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (Jan. 5, 2012).

[76] In the preamble to the proposed rules, the Board states that the proposal would apply the same set of enhanced prudential standards to bank holding companies and nonbank financial companies. 77 Fed. Reg. at 597. But the preamble further states that the Board may determine to tailor the application of the standards to different companies on an individual basis or by category, particularly for nonbank financial companies that are organized and operated differently from banking organizations. Such tailoring will apparently occur after the nonbank financial company has been designated under § 113. *Id.* No companies have yet been designated under § 113. Thus, at the current time the scale of minimum capital and liquidity requirements for nonbank financial companies and intermediate banking companies cannot be determined.

[77] If the intermediate holding company is also a savings and loan holding company, then the Board will administer both the source-of-strength requirement in § 167(b) with respect to the companies controlling the intermediate holding company and the source-of-financial-strength requirement in § 616(d). If the insured depository subsidiary is exempt from the definition of "bank" in the BHC Act, then either the FDIC or the OCC as the case may be would administer the requirements of § 616(d) with respect to the companies, including the intermediate holding company, that control the exempt entity. If the insured depository institution is a limited purpose trust savings association, the intermediate holding company and a company controlling it will not be a savings and loan holding company. 12 U.S.C. § 1467a(a)(1)(D)(ii) (2011). Arguably, the FDIC or the OCC as the case may be would have to administer the requirements of § 616(d) with respect to the intermediate holding

company and any company controlling the intermediate holding company. 12 U.S.C. § 1831o-1(b) (2011).

[78] 12 U.S.C. § 1467b (2011).

[79] 12 U.S.C. § 5365(d) (2011). The Board and the FDIC have implemented the requirements of § 165(d) by issuing rules describing the contents of the required resolution plan. *See* Resolution Plans Required, 76 Fed. Reg. 67,323 (Nov. 1, 2011).

[80] For a general discussion of the requirements of a resolution plan, see Gregory J. Lyons *et al.*, *Resolution Planning: The National, International and Strategic Context*, 8 J. of Bankr. Law 193 (2012).

[81] *See* Paul L. Lee, *The Source-of-Strength Doctrine: Revered and Revisited – Part I*, 129 Banking Law J. 771, 780 (2012).

[82] 11 U.S.C. § 365(o) (2011).

[83] *See*, *e.g.*, *Wolkowitz v. FDIC (In re Imperial Credit Industries)*, 527 F.3d 959 (9th Cir. 2008); *Resolution Trust Corp. v. Firstcorp (In re Firstcorp)*, 973 F.2d 243 (4th Cir. 1992).

[84] 11 U.S.C. § 507(a)(9) (2011).

[85] *See FDIC v. AmTrust Financial Corp. (In re AmTrust Financial Corp.)*, 2012 WL 4039755 (6th Cir. Sept. 14, 2012).

[86] *Id*. at 7.

[87] *FDIC v. AmTrust Financial Corp*., 2011 WL 334976 (N.D. Jan. 21, Ohio 2011).

[88] *FDIC v. AmTrust Financial Corp. (In re AmTrust Financial Corp.)*, 2012 WL 4039755 at 15-16.

[89] *In re Colonial BancGroup*, 436 B.R. 713 (Bankr. M.D. Ala. 2010) (appeal filed).

[90] 436 B.R. at 730.

[91] *Id*.

[92] 436 B.R. at 730 n.15. The bankruptcy court was presumably relying on the reasoning and not the holding of the Fifth Circuit decision in the *MCorp* case, because the holding itself was reversed on jurisdictional grounds by the Supreme Court. *MCorp Financial v. Board of Governors*, 900 F.2d 852 (5th Cir. 1990), *aff'd in part*, *rev'd in part*, 502 U.S. 32 (1991).

[93] 436 B.R. at 731.

[94] *Id*. at 735.

[95] 2012 WL 4039755 at 15-16.

[96] *See OTS v. Overland Park Financial Corp. (In re Overland Park Financial Corp.)*, 236 F.3d 1246 (10th Cir. 2001); *Resolution Trust Corp. v. Firstcorp (In re Firstcorp)*, 973 F.2d 243 (4th Cir. 1992). This type of commitment from a holding company comes in conjunction with a written agreement or cease and desist order with the insured depository institution subsidiary that requires the depository subsidiary to achieve specified capital levels. There is an additional advantage that the federal

banking agencies may obtain in such a case from a special provision added to FDIA by the Gramm-Leach-Bliley Act. The provision codified at 12 U.S.C. § 1828(u) limits the ability of any person (including a trustee in bankruptcy) from bringing a claim against any Federal banking agency, including in its capacity as conservator or receiver, for the return of assets of an affiliate or controlling shareholder of an insured depository institution transferred to or for the benefit of the insured depository institution if at the time of the transfer the insured depository institution is "subject to any direction issued in writing by a Federal banking agency to increase its capital." 12 U.S.C. § 1828(u)(1)(2011). For purposes of this provision, claim means a cause of action that provides for the avoidance of preferential or fraudulent transfers or conveyances or similar remedies for inferential or fraudulent transfers or conveyances other than any claim based on actual intent to hinder, delay or defraud. 12 U.S.C. § 1828(u)(2)(2011). This provision should protect the federal banking agencies from claims based on constructive intent. For a further discussion of this provision, *see* James D. Higgason, Jr., *Fraudulent Transfer Remedies Available to Bank Holding Company Bankruptcy Trustees After Gramm-Leach-Bliley*, 127 Banking L.J. 3 (2010).

[97] *See Wolkowitz v. FDIC (In re Imperial Credit Industries)*, 527 F.3d 959.

[98] Based on the experience in the recent financial crisis, a skeptic might question the extent of any prophylactic effect from the source-of-strength doctrine. Even if there were to be little empirical basis to support a prophylactic benefit from the source-of-strength doctrine, commentators favoring the doctrine would argue that the doctrine is still necessary and appropriate from the perspective of equity, *i.e.*, that the holding company should bear the loss associated with a failed bank subsidiary rather than the FDIC Deposit Insurance Fund or ultimately the federal taxpayers. *See* Lee, *supra* note 81, at 782-785.

[99] 12 U.S.C. § 1843(m) (2011).

[100] For further background on the Title II Orderly Liquidation Authority, see Paul L. Lee, *The Dodd-Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique – Part I*, 128 Banking L.J. 771 (2011) & *Part II*, 128 Banking L.J. 867 (2011).

[101] 12 U.S.C. § 5390(b)(1)(2011).

[102] 12 U.S.C. § 5390(b)(1)(A) (administrative expenses of the receiver) & (B) (amounts owed to the United States) (2011).

[103] *Cf. Wolkowitz v. FDIC (In re Imperial Credit Industries)*, 527 F.3d at 975 (holding that a claim based on a guarantee of a capital restoration plan is not entitled to an administrative priority under § 507(a)(2) of the Bankruptcy Code). An amount owed to the FDIC as receiver for an insured depository institution would not appear to be an amount owed to the United States. *See* 12 C.F.R. § 380.23(a) (2011) (definition of the term "amounts owed to the United States" for purposes of Title II).

[104] In certain of the bankruptcy cases that have upheld § 365(o) and § 507(a)(9) treatment of a commitment to maintain capital, the FDIC sued both in its corporate capacity and in its capacity as receiver for the failed depository subsidiary. *See, e.g.*, *Wolkowitz v. FDIC (In re Imperial Credit Industries)*, 527 F.3d 959 (involving a guarantee of a capital restoration plan under § 38 of the FDIA). Even in a case in which the FDIC could make a claim in its corporate capacity, it is not clear that the amount of any such claim is "owed to the United States" because the amount recovered would presumably be paid over to the receivership estate of the insured depository institution. The definition of the term "amounts owed to the United States" in the FDIC implementing rules for Title II does not clearly answer whether a claim of this type that the FDIC makes in its corporate capacity would be treated as an amount owed to the United States. *See* 12 C.F.R. § 380.23(a). *See also* Certain Orderly Liquidation Authority Provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 41626, 41632 (July 15, 2011).

[105] 12 U.S.C. § 5390(b)(1)(E) (2011).

[106] *See* 12 C.F.R. § 380.22(a) (2011) (definition of the term "administrative expenses of the receiver" for purposes of Title II). Under 12 U.S.C. § 5384(d), the FDIC may make funding available to the receivership to make the capital contribution (subject to compliance with the provisions of § 5390(n)(9)) and will be entitled to a priority for the repayment of such funding. *See* 12 C.F.R. § 380.21(a)(1) & (3) (2011).

[107] The FDIC has indicated that its preferred approach to the use of the Title II Orderly Liquidation Authority would be to place the parent company into receivership and pass its assets, principally investments in its subsidiaries, to a newly created bridge holding company. *See* Martin J. Gruenberg, Acting Chairman, FDIC, Remarks to the 48th Annual Federal Reserve Bank of Chicago Conference on Bank Structure and Competition (May 10, 2012). This approach is designed to allow "equity solvent" subsidiaries to remain open and avoid being placed into their own receivership or bankruptcy proceedings. *Id*. Even where this hypothesized approach is feasible, it will still pose conflict of interest issues for the FDIC. The bridge holding company will presumably succeed to the source-of-strength requirement of the covered company with respect to the insured depository institution subsidiary. The bridge holding company will be required to make choices between supporting its insured depository institution subsidiary and its other subsidiaries, including possibly systemically important subsidiaries. Those choices could ultimately determine where losses would occur and hence whether the Deposit Insurance Fund under the FDIA or the Orderly Liquidation Fund under Title II could be tapped to cover the losses. Decisions as to the structure of the bridge holding company and its ongoing operations will invariably involve conflicts of interest for the FDIC acting in dual

capacities as receiver for the covered company and as receiver or potential receiver for an insured depository institution subsidiary.

[108] *Cf.* 12 U.S.C. § 5390(b)(6) (2011) (providing a priority for certain claims of the Securities Investor Protection Corporation in the case of a broker or dealer subject to a Title II orderly liquidation proceeding).

[109] Title II prohibits the use of funds from the Deposit Insurance Fund to assist a covered financial company. 12 U.S.C. § 5390(n)(8)(A)(ii) (2011). It appears that Title II does not prohibit the use of the authorities of the FDIC under Title II to assist the Deposit Insurance Fund. 12 U.S.C. § 5390(n)(8)(A)(i) (2011).

[110] 12 U.S.C. § 5389 (2011).

[111] *See* 12 C.F.R. § Part 380 (2011).

[112] 12 U.S.C. § 5390(o)(1)(D)(ii) (2011). Title II creates an Orderly Liquidation Fund, which is to be used to repay the costs of the Title II process, including repayment of all amounts borrowed from the Treasury Department to faciliate the orderly liquidation of a covered financial company. 12 U.S.C. § 5390(n)(1). The Orderly Liquidation Fund will be funded by assessments on certain creditors who receive "additional" payments in an orderly liquidation proceeding and then by assessments on bank holding companies with total consolidated assets of $50 billion or more, nonbank financial companies designated under Section 113 of the Dodd-Frank Act, and other "financial companies" (as that term is defined in Title II) with total consolidated assets of $50 billion or more. Title II directs the FDIC in consultation with the secretary of the treasury to issue regulations to carry out the assessment provisions of Title II. 12 U.S.C. 5390(o)(6). No regulations have yet been proposed.