Banking Regulation 2021

Contributing editors
Gregory J Lyons, Alison M Hashmall, Chen Xu, Josie Dikkers and Amy Aixi Zhang
Debevoise & Plimpton LLP

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Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development manager
Adam Sargent
adam.sargent@gettingthedealthrough.com

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Lexology Getting The Deal Through is delighted to publish the fourteenth edition of *Banking Regulation*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Greece.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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Gregory J Lyons, Alison M Hashmall, Chen Xu, Josie Dikkers and Amy Aixi Zhang

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REGULATORY FRAMEWORK

Key policies

1 What are the principal governmental and regulatory policies that govern the banking sector?

Given their importance to the US economy, banking organisations are among the most highly regulated institutions in the United States. Broadly speaking, governmental and regulatory policies have two areas of focus: (1) the safety and soundness of the banking organisations themselves; and (2) promoting economic and social objectives.

As to the first area, banking organisations are subject to a wide range of laws, regulations and policies limiting their activities. While a typical US corporation can engage in any activity that is not prohibited by law, a bank can only engage in activities permitted by the banking laws. In addition, banking organisations must maintain minimum capital and liquidity levels.

As to the second area, banking organisations are, among other things, subject to a wide range of consumer protection laws designed to ensure non-discriminatory access to banking services, as well as stringent anti-money laundering requirements to facilitate the government identifying illegal financial activity. Moreover, given their unique role as a financial bridge between the government and customers, they also facilitate the government's transmission of monetary policy, such as the credit facilities designed to promote economic stability during the covid-19 pandemic.

Regulated institutions

2 What are the defining characteristics of a bank to be caught by the banking laws and regulations? Is non-bank fintech regulated differently?

The current US bank regulatory regime is often referred to as an entity-based regulatory approach; obtaining a banking charter is a prerequisite for being subject to many banking laws. As to when a banking charter is needed, while (non-bank) fintech companies have encroached on many services that traditionally were the exclusive domain of banks, such as lending, the two services that typically require a bank charter are trust services and taking deposits insured by the Federal Deposit Insurance Corporation (FDIC). In fact, several states obtained a court decision declaring that (except in the case of an institution exclusively engaged in trust services) taking deposits is a prerequisite to obtaining a federal bank charter (*Lacewell v. Office of the Comptroller of the Currency*, Case 1:18-cv-08377 (S.D.N.Y. Sept. 14, 2018)).

The extent to which the range of banking laws applies to a particular banking organisation thus depends in part on the nature of its charter. For example, limited-purpose state trust companies without FDIC insurance are typically subject to a relatively limited number of banking laws in their chartering state. On the other hand, FDIC-insured, full-service state or federally chartered banks are subject to a wide array of federal (and potentially state) regulation.

Fintech companies currently engage in a wide array of activities formerly exclusively performed by banks, such as retail and commercial lending and payment services. Because they do not have bank charters, they are not subject to the typical range of banking laws. However, they may be subject to the relevant laws and licensing requirements of the states in which they have customers, which can impose significant burdens on their operations.

3 Do the rules vary depending on the size or complexity of the banking institution?

Yes. The 2007–2008 financial crisis resulted in the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act), which sought to create meaningful differences in the capital, liquidity and oversight expectations of banking organisations depending on their size and complexity. (Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).) While imposing the most stringent requirements on the largest US banking organisations, the Dodd–Frank Act generally imposed significantly enhanced burdens on all banking organisations with over $50 billion of assets.

More recently, the Federal Reserve Board (FRB) has led an effort to further tailor these enhanced burdens to more accurately reflect the size and complexity of banking organisations. This tailoring framework was developed in response to the Economic Growth, Regulatory Relief and Consumer Protection Act (2018), which mandated certain tailored prudential standards for banking organisations with between $100 to $250 billion in assets. The FRB's revised rules, effective at the end of 2019, divided these larger banking organisations into four categories, with Category I having the most stringent burdens and Category IV the least stringent on a relative basis:

- Category I – US global systemically important banks (GSIBs).
- Category II – firms that are not US GSIBs that have greater than or equal to $700 billion in total consolidated assets, or greater than or equal to $100 billion in total consolidated assets and greater than or equal to $75 billion in cross-jurisdictional activity.
- Category III – firms not in Category I or II that have greater than or equal to $250 billion in total consolidated assets, or greater than or equal to $100 billion in total consolidated assets and greater than $75 billion in any of the three following specific risk indicators: (1) weighted short-term wholesale funding, (2) non-bank assets, or (3) off-balance sheet exposure.
- Category IV – firms not in Category I, II or III that have greater than or equal to $100 billion in total consolidated assets.

Primary and secondary legislation

4 Summarise the primary statutes and regulations that govern the banking industry.

The specific laws and regulations applicable to a particular banking organisation will depend principally on its charter, activities and size. Among the most significant federal statutes that govern the banking industry are:

- The Federal Reserve Act (FRA), which established the Federal Reserve System that is responsible for managing the supply of money, providing oversight to banking organisations, and acting as a lender of last resort.
- The Federal Deposit Insurance Act (FDI Act), which established the Federal Deposit Insurance Fund and gave the FDIC responsibility for regulating FDIC-insured banks.
- The Home Owners' Loan Act (HOLA), which regulates savings associations (thrifts) and savings and loan holding companies (SLHCs).
- The Bank Holding Company Act (BHC Act), which granted the FRB regulation and supervision over companies that control a bank (bank holding companies (BHCs)).
- The National Bank Act, which established the national banking system and the Office of the Comptroller of the Currency (OCC) charged with regulating national banks.
- The International Banking Act (IBA), which established that foreign banking organisations (FBOs) having operations in the United States are subject to regulation by US banking regulators.
- The Dodd–Frank ACt, which significantly reformed the financial regulatory system after the Great Recession. The Dodd–Frank Act established the Consumer Financial Protection Bureau (CFPB) to focus on consumer and investor protections.
- The Community Reinvestment Act of 1977 (CRA), which required banks to lend to the moderate and low-income residents of their service area.
- The banking laws of each of the 50 states.

Certain key FRB regulations promulgated under these Acts include:

- Regulation Q, which sets minimum capital requirements and capital adequacy standards for state-chartered banks that are members of the Federal Reserve System (member banks and BHCs).
- Regulation K, which governs the international banking operations of US banking organisations and US operations of FBOs.
- Regulation Y and Regulation LL, which describe various requirements for BHCs and SLHCs including transactions for which BHCs and SLHCs must seek and receive FRB approval.
- Regulation W, which provides rules for the types of transactions that can occur between a Member Bank (or a US branch or agency of a foreign bank) and its affiliates.
- Regulation YY, which establishes enhanced prudential standards for certain large BHCs and FBOs.
- Regulation VV, which restricts proprietary trading and investments or certain other relationships with hedge funds and private equity funds.
- Regulation O, which regulates the credit extensions that a member bank can offer its executive officers, principal shareholders and directors.

In many cases, the OCC and FDIC have published parallel regulations that cover the entities that they regulate.

Regulatory authorities

5 Which regulatory authorities are primarily responsible for overseeing banks?

Unlike many other countries, the United States has several types of banking organisations and several federal and state bank regulatory agencies that oversee them.

National banks and federal savings banks are subject to primary supervision by the OCC. State banks are subject to the jurisdiction of their chartering state, and at the federal level to oversight by either the FRB (if they are member banks) or the FDIC (if they are not member banks). The FRB is the primary regulator for BHCs and SLHCs. Federally insured credit unions are supervised by the National Credit Union Administration.

The CFPB, which has a primary focus on the protection of consumers and enforcement of consumer protection laws, also has examination authority over banks with assets of $10 billion or more.

Government deposit insurance

6 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

FDIC deposit insurance, which is backed by the full faith and credit of the US government, insures up to $250,000 per depositor, per FDIC-insured bank, per ownership category.

As a general matter, the US government does not seek to maintain ownership interests in the banking sector. Nonetheless, the US government has taken an ownership interest in the banking sector through various programmes during periods of financial difficulty. Most notably, in 2008, the Treasury established the Capital Purchase Program under the Troubled Asset Relief Program, which purchased over $200 billion in shares in over 700 financial institutions to recapitalise the banking system. These programmes subsequently wound down and the government exited their investments.

Transactions between affiliates

7 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Sections 23A and 23B of the FRA and FRB Regulation W promulgated thereunder, are designed to ensure that banks are protected in their dealings with affiliates. The types of transactions covered include extensions of credit by the member bank (or US branch or agency of an FBO) to its affiliates, purchases of affiliate assets by the bank, and certain other credit transactions. Unless an exemption applies, banks may engage in these types of 'covered transactions' with their affiliates only if (1) the aggregate amount of covered transactions of the member bank and its subsidiaries with any one affiliate does not exceed 10 per cent of the capital stock and surplus of the member bank; and (2) the aggregate amount of covered transactions of the member bank and its subsidiaries with all affiliates does not exceed 20 per cent of the capital stock and surplus of the member bank. In addition, credit transactions have specific collateral requirements, and all transactions with affiliates, including service contracts, must be on no less favourable than arm's-length terms to the bank.

An 'affiliate' for these purposes includes any company:

- that controls the bank or thrift;

- that is under common control with the bank or thrift;
- with a majority of interlocking directors with a bank or thrift; or
- that is sponsored or advised by a bank or thrift.

Regulatory challenges

8 | What are the principal regulatory challenges facing the banking industry?

Fintech companies struggle with significant compliance burdens under the existing regulatory framework. Because these businesses are not subject to fintech-specific rules, US banking regulations apply licensing and registration requirements to fintech companies at both the federal and state level. The number and complexity of regulations that may apply have drawn criticism as potential chilling effects on innovation and growth.

Some regulators have sought to address these burdens: for example, the OCC created a special purpose national bank charter for fintech companies offering bank products and services. The FDIC has approved final rules governing industrial loan companies that allow major businesses to seek banking charters while escaping capital and liquidity demands for financial firms. The CFTC created LabCFTC to develop rules around fintech innovation in capital market futures products. In December 2020, the OCC, FRB and FDIC jointly announced a proposed rule that would require banks to notify their regulators within 36 hours of a 'computer-related incident' that rises to the level of a 'notification incident'.

Consumer protection

9 | Are banks subject to consumer protection rules?

US banking organisations are subject to extensive consumer protection rules at both the federal and state level, regardless of their chartering authority. At the federal level, banking organisations with assets in excess of $10 billion, as well as their affiliates, are generally subject to examination by the CFPB (with authority for certain regulatory frameworks retained by the primary federal bank regulators, including the OCC, FRB or FDIC), while those with assets of $10 billion or less are subject to examination by their respective primary federal bank, with respect to consumer protection rules.

- fair lending (Equal Credit Opportunity Act, Fair Housing Act);
- consumer credit (Truth in Lending Act, Fair Credit Reporting Act, Military Lending Act, Servicemembers' Civil Relief Act);
- payday lending, vehicle title loans, and high-cost installment loans (the Dodd–Frank Act's authority to regulate unfair, deceptive or abusive acts or practices, or UDAAP);
- mortgage disclosures (Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act);
- deposits, checks, and collections (Truth in Savings Act);
- electronic fund transfers and prepaid cards (Electronic Fund Transfers Act, CARD Act);
- data privacy (the privacy provisions of the Gramm–Leach–Bliley Act);
- debt collection (Fair Debt Collection Practices Act); and
- any other act or practice that may be deemed to be 'unfair', 'deceptive', or 'abusive' in accordance with the Dodd-Frank Act's UDAAP requirements.

As noted above, states may also impose their own consumer protection laws – including those topics outlined above – though subject to federal pre-emption unless state requirements provide more protection to consumers. Additionally, banking organisations are generally subject to the usury laws of their respective home states, though interstate banks may be permitted to utilise the usury laws of host states under certain circumstances.

Future changes

10 | In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Banking agency appointees of the Biden administration will drive immediate priorities for legal and regulatory policy over the next few years. Regulator principals and deputies are likely to be drawn from Obama-era personnel reflecting a tougher stance on regulation of the largest banks. These leaders will likely review existing capital and liquidation requirements, resolution and recovery planning, risk management procedures, disclosure requirements and other areas over the next few years.

House Financial Services Committee Chairwoman Maxine Waters sent a letter to President Biden recommending areas where the Biden Administration should reverse Trump-era rules in favour of stronger consumer protection regulations. President Biden announced on 18 January 2021 that Rohit Chopra will be the nominee for the next CFPB director; the agency is likely to increase enforcement actions after the number fell dramatically during the Trump administration, with an emphasis on ensuring compliance with pandemic-related consumer relief.

The OCC's new director will likely focus his term on a number of issues including cryptocurrency, cybersecurity, national security and money laundering. President Biden will also have the opportunity to shape the five-member FDIC board and seven-member FRB.

SUPERVISION

Extent of oversight

11 | How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Bank supervision is used as a means to ensure that banks comply with applicable rules and regulations by allowing regulators to identify and mitigate specific risks within a banking organisation, as well as evaluate the banking system as a whole. Banks are supervised by their primary regulator, which is determined based on the bank's charter type. Bank holding companies (BHCs) and savings and loan holding companies are supervised by the Federal Reserve Board (FRB). Furthermore, larger banks are also subject to supervision for compliance with consumer protection laws and regulations by the Consumer Financial Protection Bureau (CFPB).

Regulators have two primary methods to supervise banks: reporting requirements for continuous monitoring and periodic examinations. Full-scope, on-site examinations must be conducted at least once every 12 months, except for smaller banks with less than $3 billion in assets, which are examined once every 18 months. Bank examiners will rate a bank based on components of capital adequacy, asset quality, management earnings, liquidity and sensitivity to market risk. Banks will also receive a composite rating based on these components. Any issues may require more frequent or detailed exams as well as corrective action.

Enforcement

12 | How do the regulatory authorities enforce banking laws and regulations?

The primary federal banking regulators with authority to enforce banking laws and regulations are the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), FRB and, for banking organisations with over $10 billion of assets, CFPB. These agencies have a variety of enforcement mechanisms, which range from less severe informal actions to more severe formal actions. Informal actions ordinarily are not enforceable in court.

Informal actions include supervisory criticisms (Matters Requiring Attention and Matters Requiring Immediate Attention) in exam reports, bank board resolutions and memoranda of understanding. These are not public actions, and are generally used for less severe situations where regulators believe the bank is able to, and will, correct the issue in a reasonably prompt fashion.

Formal actions include written agreements, cease and desist orders, civil money penalties and removal orders. Formal actions also often result in downgraded examination ratings for banks, which in turn can limit their ability to complete acquisitions or engage in new activities, and often involve costly compliance efforts to remediate. Provisions contained in these types of actions generally can be enforced in federal court.

13 | What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

US authorities have dedicated increasing resources to combat illicit financial activity, with a focus on Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance programmes, significant criminal cases involving economic sanctions violations, and regulation of cryptocurrencies. The Financial Crimes Enforcement Network (FinCEN) announced the launch of the Global Investigations Division in 2019 with a mandate of carrying out targeted investigation strategies to combat illicit finance threats and related crimes. The federal banking regulators also have indicated that BSA/AML enforcement remains a priority: in August 2020, the FRB, FDIC, National Credit Union Administration and OCC issued a joint statement explaining their approach to BSA/AML enforcement and outlining scenarios under which formal actions may be taken against institutions under their jurisdiction. FinCEN issued separate, similar guidance shortly thereafter, describing factors that will be relevant when the agency considers taking action for BSA violations.

RESOLUTION

Government takeovers

14 | In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

If a bank has become – or is at risk of becoming – insolvent, there are two means by which the government can step in to resolve the failed institution.

The first method of resolution is solely for insured depository institutions (IDIs) and is governed by sections 11 and 13 of the Federal Deposit Insurance Act (FDI Act). If an IDI fails, it will be placed into receivership with the Federal Deposit Insurance Corporation (FDIC) as its receiver. The FDIC will succeed by operation of law to all rights, powers and privileges of the failed bank and its stockholders, directors and officers. The FDIC is obligated to minimise cost to the Deposit Insurance Fund, and it will seek to resolve the bank in a manner that is least disruptive to depositors and the local community and that will maintain public confidence in the US financial system. Insured deposits will be paid and remaining proceeds will be paid to creditors, whereas shareholders may not receive any payments.

The second method of resolution was enacted in 2010 under Title II of the Dodd–Frank Act. The Dodd–Frank Act created the orderly liquidation authority for a 'financial company' (a broadly defined term that could include a bank holding company (BHC) or other bank affiliate) to be placed into an FDIC receivership process if resolution through bankruptcy would have serious adverse effects on financial stability. The orderly liquidation authority must be invoked by the US Treasury upon the recommendation of certain regulatory agencies and in consultation with the President. If invoked, the FDIC would have broad authority to resolve the financial company using powers similar to those that it uses to resolve IDIs under the FDI Act.

The FDIC has frequently used the FDI Act to place IDIs into receivership, especially during periods of bank failures, such as during the savings and loan crisis from 1986 to 1994 and during the recent financial crisis in 2008. The orderly liquidation authority under Title II, by contrast, has yet to be invoked.

Bank failures

15 | What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Bank management and directors have a limited role in the resolution process. When the FDIC is appointed as receiver for a bank under the FDI Act, the FDIC succeeds to all the rights, powers and privileges of the directors and officers of the institution. In the case of an orderly liquidation under Title II, the FDIC is required to ensure that management and directors responsible for the failed condition of the financial company are removed.

Large banks and BHCs are required periodically to file resolution plans or living wills.

16 | Are managers or directors personally liable in the case of a bank failure?

After the FDIC is appointed receiver over a bank, the agency may conduct investigations and bring suits against former directors or officers. Most cases result from demonstrated failures to satisfy the duties of loyalty and care. Examples include cases where the director or officer engaged in dishonest conduct, was responsible for the failure of the bank to adhere to applicable laws and regulations, or participated in a safety or soundness violation.

Planning exercises

17 | Describe any resolution planning or similar exercises that banks are required to conduct.

The Dodd–Frank Act requires large BHCs and non-bank systemically important financial institutions to submit resolution plans to the FDIC and the Federal Reserve Board (FRB) to prepare for a rapid and orderly resolution under the Bankruptcy Code. The plans require the submission of a resolution strategy for how the financial institution can be resolved without serious adverse effects on US financial stability, as well as information regarding the financial institution's material legal entities, core business lines, and operations that are critical to the US financial system, and its financial, operational and external dependencies and interconnections, among other information relevant to resolution.

The resolution plan used to be required for financial institutions with $50 billion or more in assets. In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act raised the threshold to $250 billion, and gave the FRB discretion to apply the requirement to firms with total consolidated assets of between $100 billion and $250 billion. In 2019, the FRB and the FDIC revised the implementing regulations to state that financial institutions with total consolidated assets of less than $100 billion do not have to file resolution plans and only certain firms (based on tailoring factors) with total assets between $100 and $250 billion are required to file plans. In addition, the resolution plan filing requirement moved from an annual to a two- or three-year submission cycle, depending on the firm's category under the FRB's tailoring rules, with the largest firms being required to alternate between filing a full

and 'targeted' resolution plan. The first targeted plans are due to be filed by the US GSIBs by 1 July 2021, and will be expected to address, among other things, the firm's response to the events surrounding the covid-19 pandemic.

The FDIC has issued a separate rule (the IDI Rule) requiring IDIs with more than $50 billion in assets to submit resolution plans to the FDIC. The resolution plan must show that the FDIC, as receiver, could resolve the IDI under the FDI Act in a manner that protects insured depositors, that maximises return from the sale of the IDI's assets and minimises the amount of any loss realised by creditors.

In 2019, the FDIC issued an advance notice of proposed rulemaking seeking comment on potential changes to the IDI Rule, including a tiered approach to resolution planning requirements, and indicated that the submission of IDI resolution plans would not be required until the rule-making process was completed. In January 2021, however, the FDIC said it would require IDIs with $100 billion or more in assets to resume resolution plan submissions, subject to further forthcoming guidance from the FDIC.

CAPITAL REQUIREMENTS

Capital adequacy

18 | Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Capital adequacy regulations, in the form of minimum ratio requirements, are a core aspect of supervision of banking organisations. Risk-based capital ratios measure the ratio of a banking organisation's eligible capital to its risk-weighted assets (balance sheet assets adjusted based on their deemed riskiness). Leverage capital ratios serve as a backstop to risk-based capital measures by measuring the ratio of a banking organisation's eligible capital to its total assets (unadjusted for risk). These capital requirements generally apply both to banks themselves, as well as their parent bank holding companies (BHCs) or savings and loan holding companies, on a consolidated basis.

Except in certain limited resolution contexts, US banking organisations generally need not make contingent capital arrangements.

19 | How are the capital adequacy guidelines enforced?

Bank regulators have at their disposal a number of statutory tools to enforce capital adequacy requirements. Most notable are bank regulators' expansive powers under the Prompt Corrective Action (PCA) framework under the FDI Act with respect to insured depository institutions (IDIs) and the Federal Reserve Board (FRB)'s powers under the BHC Act. The PCA regulations establish five PCA categories based on an IDI's capital position and mandate certain specified regulatory responses in each category, including potential restrictions on capital distributions and management fees, requiring regulatory monitoring, requiring submission of a capital restoration plan, restrictions on growth and prior approval of certain expansion proposals.

The ratios associated with the various categories are summarised below.

Category	Total risk-based capital ratio	Tier 1 Risk-based capital ratio	Common equity Tier 1 capital ratio	Tier 1 Leverage capital ratio
Well capitalised	≥10%	≥8%	≥6.5%	≥5%
Adequately capitalised	≥8%	≥6%	≥4.5%	≥4%
Undercapitalised	<8%	<6%	<4.5%	<4%
Significantly undercapitalised	<6%	<4%	<3%	<3%
Critically undercapitalised	Ratio of tangible equity to total assets ≤2%.			

The FRB has adopted a similar framework for BHCs and SLHCs that impose similar limitations, including activities limitations, on BHCs and SLHCs that are not deemed to be 'well capitalised', as well as those that do not pass its periodic 'stress test' requirements. A BHC or SLHC will be deemed to be well capitalised if it maintains a total capital ratio of 10 per cent or greater and a tier 1 capital ratio of 6 per cent or greater.

Undercapitalisation

20 | What happens in the event that a bank becomes undercapitalised?

When an IDI becomes undercapitalised (either by failing to meet capital ratios, or by regulatory determination) under the PCA framework, the relevant bank regulator must issue a warning to the bank and order the bank to take certain corrective actions to restore the bank to acceptable capital levels. The further undercapitalised an IDI becomes, the more significant the potential limitations.

All undercapitalised IDIs must submit an acceptable capital restoration plan and may not acquire any interests in any companies, establish branches or engage in new lines of business until the capital restoration plan has been accepted by its primary federal banking regulator. Before a plan can be accepted, its parent company must guarantee that the institution will comply until the bank is adequately capitalised during four consecutive quarters.

Insolvency

21 | What are the legal and regulatory processes in the event that a bank becomes insolvent?

If an IDI fails, it will be placed into receivership with the Federal Deposit Insurance Corporation (FDIC) as its receiver. The FDIC will succeed by operation of law to all rights, powers and privileges of the failed bank and its stockholders, directors and officers. The FDIC is obligated to minimise cost to the Deposit Insurance Fund, and it will seek to resolve the bank in a manner that is least disruptive to depositors and the local community and that will maintain public confidence in the US financial system. Insured deposits will be paid, and remaining proceeds will be paid to creditors, whereas shareholders may not receive any payments.

A second method of resolution was enacted in 2010 under Title II of the Dodd–Frank Act. The Dodd–Frank Act created the orderly liquidation authority for a 'financial company' (a broadly defined term that could include a BHC or other bank affiliate) to be placed into an FDIC receivership process if resolution through bankruptcy would have serious adverse effects on financial stability. The orderly liquidation authority must be invoked by the US Treasury upon the recommendation of certain regulatory agencies and in consultation with the President. If invoked, the FDIC would have broad authority to resolve the financial company using powers similar to those that it uses to resolve IDIs under the FDI Act.

Recent and future changes

22 | Have capital adequacy guidelines changed, or are they expected to change in the near future?

The federal banking agencies adopted rules implementing the Basel III framework in late 2013, and have adopted several revisions to that framework, including following the enactment of the Economic Growth, Regulatory Relief and Consumer Protection Act (2018).

In December 2017, the Basel Committee on Banking Supervision adopted revisions to the Basel III framework, which it expects member countries (including the United States) to adopt at a national level by 2022. The federal banking agencies are expected to propose revisions to their capital requirements to implement these changes in the near future.

OWNERSHIP RESTRICTIONS AND IMPLICATIONS

Controlling interest

23 | Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank (or non-bank). What constitutes 'control' for this purpose?

Both individuals and entities may own a controlling interest in a bank. An individual or group of individuals seeking to acquire a bank will need to comply with the requirements of the Change in Bank Control Act (CIBCA). Under the CIBCA, approval may be required before acquiring 10 per cent or more of the voting stock of a bank or company that controls a bank.

In general, a company that controls a bank or a bank holding company (BHC) will be regulated by the Federal Reserve Board (FRB). For this purpose, control means having the power to vote 25 per cent or more of any class of voting securities, controlling the election of a majority of the directors or trustees, or exercising a 'controlling influence' over the management or policies of the bank or holding company.

The FRB recently finalised regulations putting in place a tiered framework for determining controlling influence, under which the FRB presumes that a company exercises a controlling influence over a bank if the company owns or controls a specified percentage of the bank's voting securities and other indicia of control are present. Voting securities are defined as securities that entitle the holder to vote for or select directors, trustees or partners or entitle the holder to vote on or to direct the conduct of the operations or significant policies of the issuer. There are four tiers of the control analysis based on the ownership of voting securities of the bank or company: <5 per cent; 5 per cent to <10 per cent; 10 per cent to <15 per cent; and 15 per cent to < 25 per cent. Each higher ownership tier is accompanied by greater restrictions on various control factors.

Foreign ownership

24 | Are there any restrictions on foreign ownership of banks (or non-banks)?

Foreign banking organisations (FBOs) are generally subject to the same limitations and processes as US owners of banks pursuant to the general principle of 'national treatment'. The federal banking laws do not prohibit foreign ownership or control of US depository institutions, and the laws of states also permit foreign ownership of banks or thrifts chartered by the state. There are certain restrictions on citizenship, however, of directors of national banks and some state-chartered banks. An acquisition of a US bank or thrift by a foreign acquirer could be subject to national security review by the Committee on Foreign Investment in the United States if the transaction could result in foreign control of any 'critical infrastructure'. The FRB requires certain FBOs with a large US presence to form a US intermediate holding company to hold US subsidiaries, including bank subsidiaries.

Implications and responsibilities

25 | What are the legal and regulatory implications for entities that control banks?

A company that controls a bank, and its affiliates, are subject to banking laws, regulations, guidance and limitations on activities and operations. In particular, a bank holding company (BHC) may not engage in any activity not explicitly authorised under the BHC Act, which generally requires that companies that control banks limit their activities to financial activities. Notable supervisory and regulatory implications include that the BHC will be subject to examinations, reporting requirements and capital requirements. The BHC would be subject to periodic on- and off-site examinations to assess the risk management and financial condition of the BHC and its subsidiaries. The BHC must submit periodic reports to the FRB, including financial statements for the BHC and its subsidiaries, and reports on company ownership and organisational structure. The BHC also must comply with minimum capital requirements and overall capital adequacy standards.

An entity that is deemed to control a bank will also be subject to restrictions under sections 23A and 23B of the Federal Reserve Act. Those provisions impose qualitative and quantitative conditions and restrictions on transactions between a bank and its affiliates and require that transactions between a bank and its affiliates be on 'market terms'.

26 | What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The Dodd–Frank Act imposes a source-of-financial-strength requirement for any company that directly or indirectly controls an insured depository institution. This requirement mandates that the controlling company of a bank must be able to provide financial and managerial assistance to the bank in the event of its financial distress. Under this doctrine, any company that controls a bank, regardless of whether it is a BHC under the BHC Act, must serve as a source of strength. Individuals, however, are not subject to the requirement.

27 | What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

If a bank becomes insolvent, it may be placed into receivership with the Federal Deposit Insurance Corporation (FDIC) as receiver. The FDIC will then have broad authority to resolve the bank. The FDIC may conduct investigations and bring suits against former directors or officers.

CHANGES IN CONTROL

Required approvals

28 | Describe the regulatory approvals needed to acquire control of a bank (or non-bank). How is 'control' defined for this purpose?

Transactions to acquire control of a bank are governed by the Change in Bank Control Act (CIBCA), the Bank Holding Company Act (BHC Act), the Home Owners' Loan Act (HOLA) and the Bank Merger Act. The meaning of control for this purpose is discussed above.

The CIBCA seeks to ensure that acquisitions of banks by individuals do not cause competitive or safety and soundness concerns. It mandates that any individual or company acquiring control of a bank must provide prior notice to the appropriate federal banking agency

of the target bank. It requires regulators to approve or disapprove an acquisition within a specified time period. If the time period has expired without agency disapproval, the transaction can go forward. The CIBCA does not apply to transactions that require approval separately under the BHC Act, HOLA or the Bank Merger Act.

Under the BHC Act, if a company seeks to acquire control of a bank or bank holding company (BHC), it will require prior approval by the Federal Reserve Board (FRB). FRB approval is also required under HOLA for acquisition of control of a savings association.

The Bank Merger Act requires that mergers between depository institutions receive prior approval of the primary federal regulatory of the resulting institution.

Foreign acquirers

29 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Under the International Banking Act, a foreign bank with a US commercial banking presence, and any of its parent companies, is subject to many of the same laws that regulate the activities of US BHCs.

Beginning in July 2016, the FRB required certain foreign banks to hold US-based subsidiaries, including depository institutions subsidiaries and broker-dealer subsidiaries, in an intermediate holding company (IHC) to act as the parent company of all of the foreign banking organisation's (FBO) US subsidiaries. The rule applied to FBOs with $50 billion or more in US non-branch assets and was an effort to consolidate supervision. The FRB could then treat the IHC as a domestic BHC and require it to comply with capital, stress testing, liquidity, risk management and other regulatory requirements.

30 Under what circumstances can a foreign bank (or non-bank) establish an office and engage in business? For example, can it establish a branch or must it form or acquire a locally chartered bank?

An FBO generally will be treated as a BHC under the BHC Act. FBOs that wish to establish a US banking presence or otherwise take part in deposit-taking activities in the United States may not do so through a branch office insured by the FDIC, but instead must establish or acquire an insured US bank subsidiary. All foreign banks must limit their US activities to those not requiring FDIC insurance. Foreign reserve services and privileges are open to foreign bank branches, but they are also subject to all supervision and enforcement requirements of US banking agencies.

State law determines whether a foreign bank with a branch in a state may establish additional branches in that state. For this reason, a foreign bank that is establishing additional branches may prefer a federal license in many states.

Factors considered by authorities

31 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank (or non-bank)?

In reviewing an application for control of a bank, the BHC Act and the Bank Merger Act require federal regulators to consider various enumerated factors with respect to both the applicant and the bank. These factors include the effect on competition, the financial and managerial resources and future prospects of the two entities, the competence, experience and integrity of the officers, directors and principal shareholders, the convenience and needs of the communities to be served, and any impact the transaction will have on the banking or financial system.

Similarly, under the CIBCA, a notice of change in control can be disapproved if the proposed acquisition of control would result in a monopoly, might substantially lessen competition, if the financial condition of any acquiring person or the future prospects of the bank might jeopardise the financial stability of the bank, or the competence, experience or integrity of any acquiring person or the proposed management personnel indicates that it would not be in the interest of depositors or the public to permit that person to control the bank, or if the proposed acquisition would result in an adverse effect on the Federal Deposit Insurance Fund.

Filing requirements

32 Describe the required filings for an acquisition of control of a bank.

The filings that are required for the acquisition of control of a bank depend on what type of transaction is contemplated and what statute and regulations govern the transaction. Examples of filings include a Bank Merger Act Application, a Notice of Change in Bank Control, an Application to Become a Bank Holding Company and/or Acquire an Additional Bank or Bank Holding Company, and an Application for a Foreign Organization to Acquire a US Bank or Bank Holding Company. All of these filings require a detailed description of the transaction and detailed financial and management information of the applicant and potential subsidiary or target company.

Time frame for approval

33 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

In the first half of 2020, the average number of days for the FRB to approve an M&A proposal was 62 days. However, the FRB may receive adverse public comments with respect to an M&A proposal, which would likely increase the length of time it takes to approve the merger, as the FRB will allow the applicant the opportunity to respond to the comment, and then the FRB will evaluate both the comment and the applicant's response. In the first half of 2020, no proposals subject to adverse public comments were approved. In 2019, the average processing time for proposals with adverse public comments was 143 days versus an average of 56 days for proposals not receiving adverse public comments.

UPDATE AND TRENDS

Key developments of the past year

34 Are there any emerging trends or hot topics in banking regulation in your jurisdiction?

US financial regulators have devoted significant attention in recent years to fintech. For example, at the federal level, the Office of the Comptroller of the Currency under the prior administration began offering special purpose national bank charters for fintech companies. At the state level, in 2020, the New York State Department of Financial Services updated its BitLicense regulatory regime, which governs virtual currency activity and Wyoming approved the first special purpose depository institution charter, which allows banks to engage in activities related to digital assets.

Under the Biden administration, there is expected to be greater consideration as to whether fintech should be subject to similar federal regulation as banks (for example, whether fintechs engaged in substantial lending should be subject to regulation similar to the Community Reinvestment Act). The Biden administration may also bring notable changes and enhanced federal regulation especially with respect to payment systems and their anti-money laundering obligations, third-party and customer access to financial records, and digital assets.

The Biden administration is also likely to emphasise policy objectives related to environmental, social and governance (ESG) issues. Already, financial agencies and key executive designees have introduced ESG policies; the SEC may consider disclosure rules related to the environment, diversity, and political corporate spending and the FRB has discussed climate change as an important component of a bank's risk management system.

CORONAVIRUS

Coronavirus

35 What emergency legislation, relief programmes and other initiatives specific to your practice area has been implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

The Biden administration is likely to model its approach to regulating the financial services industry on the Biden–Sanders Unity Plan, a plan created as a means to unite moderate and progressive sides of the Democratic Party. Key elements include expanding equitable access to banking and financial services, equitable access to credit, protection of consumers from usurious interest rates, reversing 'over-financialization' of the American economy by separating retail banking and investment operations, and addressing rising levels of student debt.

Other stakeholders have addressed certain areas of financial regulation. Chairman Waters sent President Biden a letter recommending reversal of various Trump administration rules, and action in response to covid-19. The Chamber of Commerce provided a report with over 100 recommendations to modernise financial regulation and spur growth.

Banks also participated in the Payment Protection Program (PPP), which the US Small Business Administration extended in January 2021, authorising a second round of PPP loans pursuant to the $900 billion covid-19 relief package known as the Consolidated Appropriations Act 2021.

Gregory J Lyons
gjlyons@debevoise.com

Alison M Hashmall
ahashmall@debevoise.com

Chen Xu
cxu@debevoise.com

Josie Dikkers
jdikkers@debevoise.com

Amy Aixi Zhang
aazhang@debevoise.com

Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
Tel: +1 212 909 6566
www.debevoise.com

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