Choice of Charters Redux: OCC Governance Proposals for National Banks and Federal Thrifts

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Financial Institutions

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On July 7, 2020, the Office of the Comptroller of the Currency (OCC), primary regulator for national banks and Federal thrifts, published a lengthy proposal for significant and extensive revisions to certain of its current regulations (the Proposal). The Proposal, contained in OCC Docket 2020-0003, addresses a number of OCC regulations, including a new proposed section regarding powers and permissible activities for national banks and Federal thrifts[1]. The Proposal also includes a comprehensive review of the OCC's corporate governance regulatory framework, presently contained in 12 CFR Section 7.2000, as well as new proposed regulations impacting hours and closings. The Proposal is especially noteworthy, given that the OCC's corporate governance regulations were issued in 1996 and have since remained relatively unchanged.

Governance is a critical element of institutional oversight and is extremely important for consideration by boards of all types of institutions. As bankers and their boards consider the best available form of charter for their institutions, governance considerations should play a very significant role. Governance considerations define the legal guidelines and expectations as to board oversight obligations and performance, shareholder rights, decision-making parameters, and the nature and extent of protections for directors (acting in their roles as directors). Boards should take the time to fully research and consider which types of governance models and protections are best for their institutions and their roles in those institutions, from powers and activities to fiduciary standards and permissible protections available for serving in their roles as directors.

Some of the more notable national bank and Federal thrift governance items of interest in the Proposal are summarized below:

1. Legal Framework for Governance Considerations

- Presently, a national bank has the option to use the corporate governance provisions of either (i) the state in which the bank's main office is located, (ii) the state in which the bank's holding company is located, (iii) Delaware corporation law, or (iv) the Model Business Corporation Act.
- The Proposal would expand the ability of impacted institutions to utilize the governance laws of (i) *any* state in which the institution maintains a branch, (ii) *any* state in which one or more of the institution's holding companies are located or (iii) a combination of states (if there is more than one holding company), regardless of whether the institution later chooses to eliminate its holding company structure, to the extent that those laws are not inconsistent with applicable Federal banking statutes or regulations, or "safety and soundness". After electing its governance venue, an institution would then be permitted to modify its holding company structure without necessarily having to change its governance venue.
- The Proposal would also expand these options to Federal savings associations.
- Boards should review the various options available under the Proposal to determine which governance venue is best for their institution.

2. Anti-Takeover Provisions for National Banks

- The Proposal, if effectuated, would address the extent to which a national bank may adopt anti-takeover provisions in its governance documents. Currently, the validity of anti-takeover provisions are governed by the state law/governance venue selected by the institution (as discussed above).
- This aspect of the Proposal may "muddy the water" in part because it would limit an institution's ability to adopt anti-takeover provisions if the provisions are inconsistent with Federal statutes, regulations or "safety and soundness" considerations. The "safety and soundness" standard is amorphous, subject to considerable regulatory discretion, and has always been somewhat subjective in nature. Certain anti-takeover measures that appear proper—and may, in fact, be perfectly legal—could create "safety and soundness" concerns in the eyes of the regulatory agencies. This could result in significant uncertainty as to the enforceability of otherwise legal anti-takeover provisions found in the institution's governance documents.
- The Proposal identifies certain types of anti-takeover provisions that the OCC has determined to be inconsistent with Federal law and regulations; however, that list is subject to change. The overarching "safety and soundness" caveat remains, however, so certain anti-takeover provisions could be subject to evaluation by the OCC on a case-by-case basis, which is potentially problematic for governance planning.

3. President as a Director

- The OCC proposes to stipulate that the person serving as, "...or in the function of...", the president of a national bank must serve on the board of directors.
- Currently, presidential and other functions are determined by the governance documents of the institution and, to some degree, by historic practice and precedent.

- If the Proposal were to be adopted, it is uncertain what functions the OCC would deem "presidential" so as to trigger this requirement. Again, the Proposal would create uncertainty by permitting the OCC to make case-by-case determinations that impact the organizational structure of the institution and the board's ability to make governance determinations that align with their fiduciary obligations. This could be problematic and would require anyone serving in the position of president, as defined by the OCC, temporarily or otherwise, to also serve as a member of the board of directors.

4. Indemnification of Directors, Officers and Other Institution-Affiliated Parties (collectively IAPs)

- This is a very important part of the Proposal that would continue to allow the OCC to subjectively determine whether an IAP is subject to indemnification by a national bank or Federal thrift, irrespective of (i) relevant state law or governance protections and (ii) whether the IAP has otherwise met appropriate good faith and fiduciary governance and performance considerations. The Proposal would continue to enable the OCC to determine whether indemnification is appropriate, and therefore permissible, under the amorphous and discretionary "reasonableness" and "safety and soundness" standards.
- Under current law and regulation, the OCC can limit or prohibit indemnification payments to an IAP that result from an administrative proceeding or action by a Federal banking agency, *if* they are deemed by the OCC to be "unreasonable" and inconsistent with law and regulation. Additionally, the OCC may prohibit indemnification payments where an IAP is assessed civil monetary penalties, is removed, is subject to a prohibition order, or is required to take directed actions by the OCC in regards to an insured depository. Presently, national banks can indemnify IAPs in most instances, including for claims arising from actions other than those by a Federal banking agency, so long as they are made in accordance with applicable state law and consistent with safe and sound banking practices.
- This portion of the Proposal continues to illustrate and highlight the importance of allowing an institution's choice-of-law to provide the basis for director and other IAP responsibilities and liability, as well as the underlying ability of the institution to provide indemnification for IAPs. Subjective regulatory determinations regarding the ultimate permissibility of indemnification payments remains troubling.
- The Proposal's impact on traditional protections for IAPs remains to be seen, and the details of this portion of the Proposal are too complex and detailed for complete coverage here. However, if adopted, the Proposal would continue to create uncertainty regarding IAP liability, especially in light of the unknown potential impact of COVID-19. Allowing indemnification to continue to be subject to regulatory scrutiny will have a long-term, potentially adverse impact on the traditional protections otherwise in place for financial institutions, and make attracting and retaining good directors more difficult.

Conclusions

The Proposal helps illustrate the importance of considering and assessing, on a continual basis, what type of charter, governance structure and governance venue is best for an institution in light of its current and proposed activities and operations. It also illustrates the implications of these decisions on the ability of an institution to indemnify and to protect directors, officers and IAPs conducting the business of the institution. Forum shopping for the sake of forum shopping should not be the primary consideration.

Instead, as part of their regular oversight responsibilities, boards should conduct a careful analysis of what type of charter, and what type of governance regime, is most appropriate for their particular institution.

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[1] New, proposed 12 CFR 7.100.