Samson's Toupeé: Banking Law's Source-of-Strength Doctrine

Adam J. Levitin[†]

The source-of-strength doctrine is a long-standing pillar of bank regulation. It holds that a bank holding company (BHC) is to serve as "a source of financial and managerial strength" for its bank subsidiaries. The doctrine, however, has always been more aspirational than actual. The doctrine has never clearly imposed any liability on BHCs. Thus, it produced no ascertainable recovery for the FDIC against the BHCs of the largest banks to fail in the 2008 financial crisis.

Despite the doctrine's post-crisis codification, the situation has not changed because of the failure of the Federal Reserve Board to promulgate implementing regulations. Under current law, absent contractual agreement, when a bank fails, the BHC has no liability for the bank's obligations. The source-of-strength doctrine is as real a source of strength as Samson's toupée.

This Article renews calls made in the wake of the S&L crisis to require BHCs to be formal guarantors of the liabilities of their bank subsidiaries. This targeted curtailment of limited liability subordinates the BHC's creditors and shareholders to the bank's creditors. Doing so creates a market mechanism for sorting among positive and negative aspects of bank affiliations with nonbanks through BHCs. A BHC guaranty of the bank would mean that negative, risk-generating affiliations would result in higher capital costs for the BHC, disincentivizing those affiliations. An actualized source-of-strength doctrine would not only facilitate market discipline on risk-taking by banks but would also help protect the FDIC's deposit insurance fund by forcing losses incurred in bank resolution to be borne by BHC creditors and shareholders. And, perhaps most importantly, BHC guaranties of their subsidiary bank obligations would create a market backstop for and check on fallible regulators.

† Carmack Waterhouse Professor of Law and Finance, Georgetown University Law Center. Professor Levitin was engaged as a consultant by an investor in the debt of SVB Holding Co. after publication of a blog post that previewed the arguments detailed in this article. Thank you to Anna Gelpern, Thomas Moers Mayer, and Art Wilmarth for comments and suggestions and to Cattleya Concepcion for research assistance.

Introduction

Announcing the rescue of Silicon Valley Bank depositors, President Joseph R. Biden, Jr., took pains to emphasize that "investors in the banks will not be protected. They knowingly took a risk and when the risk didn't pay off, investors lose their money. That's how capitalism works."[1] The President's words expressed a laudable ideal, but not how US law actually works.

Silicon Valley Bank's sole direct "investor" was SVB Financial Group. SVB Financial Group is a bank holding company (BHC), meaning that it is a company that owns at least 25% of a bank's voting securities.[2] SVB Financial Group was not just the bank's shareholder, however. It was also a creditor of the bank for a deposit of around $2 billion. Additionally, SVB Financial Group was potentially a debtor of the bank based on various legal theories applicable to all entities—tort, fiduciary duties, and fraudulent transfer claims—as well as under the "source-of-strength" doctrine, a banking law doctrine that holds that a BHC is to be "a source of financial and managerial strength" for its bank subsidiary.[3]

The source-of-strength doctrine has been described as the most hallowed and revered "in the *summa theologica* of bank regulation,"[4] but exactly what it means has never been clear. As a practical matter, does the doctrine merely mean that a BHC should not be a drain on the bank subsidiary? Does it create a requirement that a BHC will provide support for a distressed bank subsidiary, and if so, up to what level? Does it make a BHC liable for the obligations of a failed bank subsidiary? And if such an obligation exists, who can enforce it? In other words, it remains undetermined if the source-of-strength doctrine is largely hortatory and aspirational or is in fact an exception to limited liability, one of the core principles of American corporate law.

The answers to these questions have important implications for the FDIC's ability to recover the costs of a bank receivership because, as with SVB Financial Group, the BHC might have considerable non-bank assets, such as non-bank subsidiaries or deposits at the failed bank. Moreover, the answers affect the extent to which there is market discipline on the bank's activities. If the BHC is answerable for the obligations of its

1. Remarks on the United States Banking System and the National Economy, 2023 DAILY COMP. PRES. DOC. 185 (Mar. 13, 2023), https://www.govinfo.gov/content/pkg/DCPD-202300185/pdf/DCPD-202300185.pdf [https://perma.cc/U6W3-NSMT].

2. 12 U.S.C. § 1841(a)(2) (defining bank holding company).

3. *See, e.g.*, Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. 794, 820 (Jan. 5, 1984) (codified at 12 C.F.R. § 225.4).

4. Paul L. Lee, *The Source of Strength Doctrine: Revered and Revisited – Part I*, 129 BANKING L.J. 771, 771 (2012).

failed subsidiary, it makes the investors in the BHC themselves more sensitive to the risks of the failure of the bank.

BHC investors are already exposed to the risks of the failure of the bank subsidiary, insofar as the value of the bank may be lost, thereby decreasing the value of the BHC.[5] But if the BHC is itself liable to the bank or its receiver, then the pool of claims for the BHC's remaining assets is expanded, diluting the recoveries of BHC investors. Making the BHC liable for the bank's liabilities structurally subordinates the BHC's creditors and shareholders to the bank's creditors, including the FDIC, who will have first claim on the BHC's assets, before the BHC's own creditors and shareholders.[6] Therefore, if source-of-strength actually makes the BHC liable for the bank, it will enhance market discipline because the riskier the bank, the higher the costs the BHC will face for external financing.

Questions about the scope of the source-of-strength doctrine are tied up with questions about its purpose. Is the doctrine designed to create a "deep pocket" from which the FDIC can recover in a receivership? Is it designed to be a regulatory prod so BHCs will keep banks from failing? Is it designed to instill market discipline by imposing losses on investors in the BHC?

The source-of-strength doctrine and related legal provisions were the focus of substantial scholarly investigation in the 1980s and early 1990s in the wake of the savings-and-loan crisis,[7] but received scant attention in the wake of the next banking crisis, that of 2008, or even after the doctrine's manqué codification in the Dodd-Frank Act.[8] This Article argues that at present the source-of-strength doctrine is, at best, aspirational, and, at worst, disingenuous. Put another way, if the BHC is supposed

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5. The source-of-strength doctrine has never been thought to make the shareholders of the BHC themselves liable for the bank's obligations. The doctrine is only about internal limited liability within the corporate group, not external limited liability.

6. A source-of-strength claim by the FDIC as receiver against a BHC would (absent priority) only have a dilutive effect on the BHC's creditors.

7. *See, e.g.*, William R. Keeton, *Bank Holding Companies, Cross-Bank Guarantees, and Source of Strength*, 75 FED. RSRV. BANK OF KAN. CITY ECON. REV. 54 (May/June 1990); Lissa L. Broome, *Redistributing Bank Insolvency Risks: Challenges to Limited Liability in the Bank Holding Company Structure*, 26 U.C. DAVIS L. REV. 936 (1992); Leonard Bierman & Donald R. Fraser, *The "Source-of-Strength" Doctrine: Formulating the Future of America's Financial Markets*, 12 ANN. REV. BANKING L. 269 (1993); Howell E. Jackson, *The Expanding Obligations of Financial Holding Companies*, 107 HARV. L. REV. 507 (1994); Cassandra Jones Havard, *Back to the Parent: Holding Company Liability for Subsidiary Banks — A Discussion of the Net Worth Maintenance Agreement, the Source of Strength Doctrine, and the Prompt Corrective Action Provision*, 16 CARDOZO L. REV. 2353 (1995).

8. The major exception is Lee, *supra* note 4. Others have in the wake of the 2008 crisis have called for curtailment of limited liability among financial institutions. *See, e.g.*, Peter Conti-Brown, *Elective Shareholder Liability*, 64 STAN. L. REV. 409, 428-41 (2008); Kevin Dowd, *Moral Hazard and the Financial Crisis*, 29 CATO J. 144, 163 (2008).

to be a source-of-strength like Samson's hair, then the doctrine as it actually exists is merely Samson's toupée.

The tests of the source-of-strength doctrine in the wake of the 2008 crisis suggest that the doctrine does not make BHCs actually liable for the debts of their subsidiary banks. Although there have not been definitive legal rulings on the doctrine, as a practical matter it has resulted in almost no recoveries for the FDIC against BHCs following recent large bank failures. The FDIC never seriously pushed its source-of-strength claims in litigation as receiver for failed banks and has settled them for virtually nothing.[9]

In other words, at least prior to the codification of the doctrine in 2010, limited liability in fact held for BHCs vis-à-vis their subsidiaries. This Article argues that the 2010 codification of the doctrine and its regulatory implementation have likely done little to change the situation, such that in the ongoing SVB Financial Group bankruptcy the FDIC did not even file a claim or invoke the doctrine in response to litigation by the holding company attempting to force the turnover of its deposits at the bank. This Article argues that it is time for a legislative reappraisal of the current codification: BHCs should be expressly liable for all of the obligations of their bank subsidiaries.[10]

Making a BHC expressly liable for the obligations of its bank subsidiaries eliminates the "internal" limited liability within the conglomerate, even as it preserves the "external" limited liability of the BHC's shareholders, who would not be liable beyond their own shares. This has the effect of disregarding the internal corporate asset partitioning within the conglomerate. There is good reason to disregard such internal asset partitioning. As Professors Henry Hansmann and Richard Squire have demonstrated, internal limited liability within a corporate group generates few if any of the socially valuable benefits that are created by exter-

9. The only partial exception to this is in the failure of the Bank of New England. Prior to the bank's failure, the FDIC and other federal regulators pressured the BHC to contribute $500 million to the bank. Branch v. FDIC, 825 F. Supp. 384, 394 (D. Mass. 1993). The BHC's bankruptcy trustee sued the FDIC arguing that the contribution was a fraudulent transfer, *id.* at 396-97, resulting in a $140 million settlement, suggesting that the FDIC retained $360 million. Associated Press, *Bank of New England, FDIC Reach Pact*, STANDARD TIMES (Jan. 11, 2011, 5:51 AM ET), https://www.southcoasttoday.com/story/business/1998/09/22/bank-new-england-creditors-fdic/50558174007 [https://perma.cc/9AV8-U73T]. *See also* James D. Higgason, Jr., Fraudulent Transfer *Remedies Available to Bank Holding Company Bankruptcy Trustees After Gramm-Leach-Bliley*, 127 BANKING L.J. 3, 4-5 (2010). This case is different, however, in that the FDIC never brought litigation to enforce source-of-strength, but instead was in the position of having to defend transfers undertaken pursuant to the doctrine.

10. The BHC guaranty should not be limited only to deposits or insured deposits. Instead, it should extend to all bank liabilities in order to disincentivize risky activities, such as derivatives trading, at the bank itself. (The swap push-out rule, 15 U.S.C. § 8305 only prohibits banks from engaging in a limited subset of swaps.)

nal limited liability limited and in fact imposes economic costs.[11] Put another way, there is, in general, scant reason to respect internal limited liability and asset partitioning.

In the banking context, there is even less reason to honor internal limited liability and asset partitioning. The existence of the BHC itself is both what creates the asset partitioning (some of which is required by regulatory activity restrictions) and what enables affiliations between banks and nonbanks. Those affiliations present substantial safety-and-soundness and competition policy concerns. The BHC may treat the bank as a captive source of below-market funding for itself or its other enterprises, imposing inadequately compensated risk on the bank and giving the nonbank affiliates an unfair advantage over competitors who have to finance at arm's length, market rates.[12] Moreover, the affiliation could pose reputational risk for the bank: problems at its nonbank affiliates could trigger a run on the bank itself out of fears of contagion. Likewise, if the bank has generated leads for its nonbank affiliates, the bank will risk losing customer relationships if the customer is unhappy with the service provided by the nonbank affiliate.

At the same time, there might be positive synergies from the affiliation that benefit the bank. For example, a nonbank affiliate, like a broker-dealer, might generate leads for its bank affiliate, and the bank might be able to piggyback on its affiliates' reputations if the affiliates are better established than the bank. The affiliation might also support specialized captive businesses that provide services that the bank cannot easily obtain elsewhere and which regulatory restrictions prevent from being performed in-house at the bank. And BHCs help smooth out operational issues in bank mergers. A direct bank-to-bank merger requires that the banks "be fully integrated on day one of the acquisition."[13] Use of a BHC structure enables a delay between acquisition and integration, which reduces the risk of problems with IT integration and other factors that could themselves affect the safety-and-soundness of the bank.[14]

This Article suggests that a robust source-of-strength doctrine actually provides a market mechanism for sorting between the positive and

11. Henry Hansmann & Richard C. Squire, *External an Internal Asset Partitioning: Corporations and Their Subsidiaries*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 1, 11-19 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018), *available at* https://ssrn.com/abstract=2733862 [https://perma.cc/JPP5-QDRL].

12. Federal Reserve Board regulations require that bank transactions with affiliates be on "terms and conditions that are consistent with safe and sound banking practices," 12 C.F.R. § 223.13, but that is not necessarily synonymous with market terms.

13. *Benefitting from the Flexibility of a Bank Holding Structure*, FED. RRSV. BANK ATLANTA, https://www.atlantafed.org/-/media/documents/banking/supervision-and-regulation/become-a-member-bank/benefiting-from-the-flexibility-of-a-bank-holding-company-structure.pdf [https://perma.cc/UNG7-PZ8K].

14. *Id.*

negative aspects of the BHC structure. Such a market mechanism would serve as a check on or backstop of regulators' fallible judgments. If BHC investors are exposed to the losses incurred by the bank, over and above the BHC's own equity investment in the bank, they will charge more for their capital, the riskier the bank is.[15] That is, if the BHC treats the bank as a captive source of funding for its nonbank affiliates, whatever benefits it gains from the below-market lending by the bank will be offset by its own higher costs of capital. But if the affiliation is only about producing positive synergies, that will not result in higher capital costs for the BHC. Thus, if source-of-strength actually made the BHC liable for the bank's obligations, it would discourage the negative uses of BHC structures, while still permitting their positive ones.

I am not the first to call for BHCs to be liable for the obligations of their bank subsidiaries. Over thirty years ago, in the wake of the S&L crisis, Professors Jonathan Macey and Geoffrey Miller suggested that the banking system might return to the regime of double liability for shareholders—making shareholders liable for the par value of their shares as well as whatever they paid for the shares—that had been common before 1933.[16] In the years following Macey and Miller's article, other scholars put forth related proposals. Professor Lissa Broome called for "holding company family liability" for BHCs and all of their nonbank subsidiaries to be liable for FDIC losses in bank resolutions.[17] Professor Howell Jackson proposed a limited BHC guaranty of bank solvency, capped at some fraction of the subsidiary's liabilities or capital requirements.[18] And Professor Cassandra Jones Havard called for the "temporary consolidation of troubled or undercapitalized banking subsidiaries within a bank holding company system,"[19] a practice that is common in Chapter 11 bankruptcies under the moniker of being a "deemed consolidation for plan and distribution purposes."[20]

The organization of the market and the lay of the land in bank regulation have both changed substantially over the past thirty years, prompting a renewed appraisal of BHC liability for the obligations of subsidiary banks. Yet the fundamental insight of all of these scholars remains accurate. All of these scholars' arguments, like mine, were motivated by the

15. This proposal will admittedly impose a higher cost of capital on banks that are structured with BHCs than those without BHCs, but the use of the a BHC has a number of offsetting attractions to most banks and also creates the possibility of greater risks—including greater socialized risks—that justify a higher cost of capital.

16. Jonathan R. Macey & Geoffrey P. Miller, *Double Liability of Bank Shareholders: History and Implications*, 27 WAKE FOREST L. REV. 31, 33 (1992).

17. Broome, *supra* note 7, at 968, 996-97.

18. Jackson, *supra* note 7, at 616.

19. Havard, *supra* note 7, at 2358-59.

20. ADAM J. LEVITIN, BUSINESS BANKRUPTCY: FINANCIAL RESTRUCTURING AND MODERN COMMERCIAL MARKETS 878-79 (3d ed. 2023).

insight that redistributing risk from the FDIC to the BHC would reduce the moral hazard created by limited liability by aligning upside and downside exposure for the BHC and would ultimately increase market discipline on bank behavior. Those concerns still obtain, and Congress's attempt to address them through the codification of the source-of-strength doctrine is an insufficient solution given its toothless regulatory implementation. Accordingly, this Article renews the call for making BHCs express guarantors—by statute or regulation—of all of their subsidiary banks' obligations.[21] Doing so will not only improve market discipline on banks and expand the possible sources of recovery for the FDIC in bank resolutions, but will also create an important market backstop for bank regulators, whose fallibility and fecklessness has been on display in every financial crisis from the S&Ls to the run-up to 2008 to Silicon Valley Bank.

This Article proceeds as follows. Part I reviews the limited liability doctrine and its federal law exceptions, considering the policy concerns that animate the federal override of state law. It also considers the particular policy concerns about limited liability in the banking context. Part II turns to the source-of-strength doctrine and traces its development up to the 2008 financial crisis. Part III considers how the doctrine played out in the largest bank failures in the 2008 crisis, those of IndyMac FSB, Washington Mutual Bank, and Colonial Bank. It shows that the doctrine was of little consequence in the subsequent bankruptcies of these banks' BHCs. Part IV turns to the codification of source-of-strength in the Dodd-Frank Act, and argues that as codified, the doctrine is toothless, such that the FDIC has yet to invoke the source-of-strength doctrine in ongoing litigation in the bankruptcy of SVB Financial Group. At the same time, however, a separate set of regulations have created something similar to source-of-strength for the BHCs of the very largest banks, but under separate statutory authority and not conceived as being part of the source-of-strength doctrine. Part V concludes with an argument for extending and regularizing this more muscular, but ersatz source-of-strength system to all BHCs through either statute or regulation.

I. Limited Liability and Its Exceptions

A. Limited Liability

One of the core assumptions of contemporary corporate law is the existence of limited liability for shareholders, meaning that the shareholders are not answerable for the obligations of a corporation beyond

21. This Article argues that a BHC should not only guaranty the insured deposits of its subsidiary bank, but all bank obligations.

the nominal value of their shares.[22] As corporate law is (aside from federally chartered corporations) a matter of state law, limited liability is a state law doctrine. This means, among other things, that it can be trumped by federal law under the Supremacy Clause of the U.S. Constitution.[23]

Although limited liability is the standard situation for virtually all corporations today, limited liability is not inherent in the use of the corporate form, and the concept developed subsequent to that of the corporation. The expansion of limited liability is one of the major doctrinal developments in corporate law in the 19th century. Thus, at the start of the 19th century, direct shareholder liability for corporate obligations in the United States was still common.[24] By the mid-19th century, however, limited liability had become commonplace, even if there were some large companies that continued to operate without it well into the middle of the 20th century.[25]

The origin story of limited liability appears to lie in sovereign immunity. Early corporate charters were exclusive charters to perform functions that had traditionally been the purview of the state, so immunity from creditors' claims came with performing state-like functions.[26] Limited liability then became more generally available in the U.S. as the result of competition among states for corporate chartering. States could attract charters by offering more attractive terms for shareholders, including limited liability, particularly if the externalities of limited liability were likely to be borne primarily by residents of other states.[27]

Although the prevalence of limited liability seems to be explained through a political economy story, there are also policy reasons to favor it. The use of the corporate form enables the pooling of capital from multiple investors, each of whom owns only a fractional interest in the corporation. The fractional ownership also facilitates diversification of investment by enabling individual shareholders to easily invest in multiple enterprises with limited contributions of capital from each shareholder.[28] The corporate form also enables a separation of ownership and management, allowing for passive owners to hire professional managerial exper-

22. *See infra* note 42.

23. U.S. CONST. art. VI, cl. 2.

24. *See* Phillip Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 588 (1986).

25. Mark I. Weinstein, *Don't Buy Shares Without It: Limited Liability Comes to American Express*, 37 J. LEGAL STUD. 189, 194 (2008).

26. STEPHEN BAINBRIDGE & TODD HENDERSON, LIMITED LIABILITY: A LEGAL AND ECONOMIC ANALYSIS 20-32 (2016).

27. *Id.* at 32-38, 52-53, 77, 230; STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL 21-30 (2013).

28. Henry Manne, *Our Two Corporate Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967).

tise. But with this separation of ownership and management comes an agency problem.

Shareholders do not run the corporation themselves. Instead, they appoint directors who appoint corporate managers. This means that shareholders exercise only very loose, indirect control of the corporation. They lack detailed information on the day-to-day operations of the corporation, and, if there is no controlling shareholder, they may face a potential collective action problem if they do want to replace the corporate directors because they need to coordinate in their removal effort. If shareholders were liable for the actions of a corporation that they cannot closely control, they would be potentially assuming risks beyond anything they intend.

Moreover, if shareholders faced unlimited joint liability, the level of risk they would assume would also relate to the capacity of their fellow shareholders to pay judgments and the particular time at which the shares were owned. As Professor Howard Bodenhorn has noted, "[u]nder unlimited liability who one invests with is as important as what one invests in."[29] With joint liability among shareholders, the pricing of corporate shares would depend on the creditworthiness of the other shareholders.[30] The need to investigate the credit of fellow investors would add substantial information costs to investment, and would be compounded by the problem of continual changes in corporate shareholder composition.[31] The effect of joint liability would be to undermine the liquidity of corporate shares, which would raise the cost of capital.

This type of agency risk would surely chill investors' willingness to invest in corporations, undermining the useful capital pooling function of the corporate form. It would also frustrate the investment diversification that fractional corporate ownership facilitates.[32] And it would undermine the liquidity of corporate shares.

Limited liability helps address the corporation's agency problem and thereby promotes the capital pooling and diversification benefits of the corporate form by shielding shareholders from responsibility for the actions of their wayward corporate agents. Limited liability also furthers liquidity of corporate shares by making their value independent of the creditworthiness of other shareholders.[33] And it improves the informational

29. Howard Bodenhorn, *Double Liability at Early American Banks* 6 (Nat'l Bureau Econ Rsch., Working Paper 21494, Aug. 2015), https://www.nber.org/papers/w21494 [https://perma.cc/6KRX-K48D] (emphasis original).

30. Hansmann & Squire, *supra* note 11, at 5-6.

31. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1882-83 (1991).

32. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 331 (1976).

33. Hansmann & Squire, *supra* note 11, at 5-6.

value of market prices because they do not reflect the identity of ownership.[34] All of these are positive aspects of limited liability. Additionally, limited liability has been defended as simply the only practical and administrable way to pool capital; without it there would be problems with judgment-proof investors, and issues of enforceability and determining who would be liable.[35]

At the same time, limited liability has been heavily critiqued as producing a moral hazard as it encourages corporations to take excessive risks because the costs are externalized onto third parties, such as tort victims, rather than internalized by the corporate shareholders.[36] Limited liability has also been described as "one of the most controversial issues in corporate law," because of the concern that it incentivizes excessive risk-taking at the expense of creditors, not all of whom can adjust.[37] Indeed, because shareholders have unlimited upside, but limited downside exposure, they are structurally incentivized to want the corporation to pursue riskier investments than if they had matched upside and downside. Because shareholders select management, they are generally able to effectuate this investment strategy.

The limited downside paired with uncapped upside puts shareholders in the economic position of owning an American-style call option on the corporation with a strike price of zero. The paid-in value of their shares is the cost of the option. The value of a call option increases with the volatility of the value of the underlying asset,[38] and the way a corporation increases the volatility of its value is to undertake riskier investment strategies. The result is a heads-I-win, tails-you-lose situation for shareholders with limited liability. If the risky investment pays off, the share-

34. *Id.* at 6.

35. *See* Janet Cooper Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387 (1992); Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387, 389 (1992).

36. *See, e.g.*, Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 7 (1996) (noting limited liability's use against non-contractual creditors); William A. Klein & Eric M. Zolt. *Business Form, Limited Liability, and Tax Regimes: Lurching Toward a Coherent Outcome?* 66 COLO L. REV. 1001, 1036 (1995) (noting how limited liability enables externalization of risks); Hansmann & Kraakman, *supra* note 31 (urging shareholder liability for corporate torts); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1616-23 (1991) (questioning limited liability within corporate group as applied to tort victims); John A. Siliciano, *Corporate Behavior and the Social Efficiency of Tort Law*, 85 MICH. L. REV. 1820, 1858 (1987) (same); Mark J. Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 40-42 (1986) (noting how limited liability can incentivize an externality on non-contractual creditors); Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 140-41, 148-49 (1980) (identifying a moral hazard problem with limited liability).

37. Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 81 (1991).

38. Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637, 638-39 (1973); Robert C. Merton, *Theory of Rational Option Pricing*, 4 BELL J. ECON. & MGMT. SCI. 141, 148 (1973).

holders reap the benefits, and if it does not, they have hazarded nothing more than the price paid for their shares.

The concern about limited liability encouraging excessive risk-taking is especially acute in banking. The high externalities of bank failure lead to a particular concern about the moral hazard produced by privatized gains and socialized losses. Bank regulation is founded on the premise that excessive risk-taking is to be discouraged for several reasons.

First, regulatory intervention is needed because the normal market check on excessive risk-taking, namely contractual debt, is ineffective with banks. Debt can have a mitigating effect on shareholders' push for excessive risk-taking because creditors—who do not benefit from the upside of high-risk/high-return investments—can bargain for protections that limit risk. Banks' main contractual creditors are depositors, but depositors are poorly positioned to constrain bank behavior because the opacity of banks' balance sheets makes it hard for them to gauge the riskiness of banks. Moreover, depositors' lack of specialization in credit monitoring; they are not looking to be investors like bondholders, but are instead creditors by virtue of the nature of the deposit relationship, which they want primarily for safekeeping and transactional purposes. Furthermore, individual depositors lack the ability and market power to actually bargain over account terms, which are presented on a take-it-or-leave-it basis in contracts of adhesion.

Second, depositors' lack of diversification makes them particularly vulnerable to losses. Diversification of transaction accounts is particularly challenging because depositors need to be able to easily make payments, and when deposits are split up among multiple banks, there is a substantial transaction cost for making payments. Third, because fractional reserve banking can leave banks with limited liquidity, a bank's failures are likely to have externalities on other banks by triggering self-fulfilling panics. Fourth, the interlinkages between banks as counterparties in various payment and derivative transactions can perhaps more readily transmit contagion from failure than in other industries. Fifth, as other banks attempt to protect themselves against panics and contagion, they are likely to call lines of credit and pull back on financing to stockpile liquidity. This in turn has a contractionary effect on the money supply and the economy. And sixth, because deposits are at least partially insured, losses from a bank failure are externalized onto the FDIC's deposit insurance fund, which as a mutual insurance fund, means that the losses are externalized onto the entire banking industry.

In short, if there is any place in the economy where it is appropriate to curtail limited liability, it is in banking. The result of these various concerns about excessive risk-taking in banking is a large and complex bank regulatory apparatus, including the source-of-strength doctrine, designed to reduce risk-taking and to mitigate the externalities of materialized risks. Bank regulation is in no small part designed as a response to the risk-taking encouraged by limited liability.

Firms often consist of a group of multiple affiliated corporations with a parent-subsidiary structure, and limited liability exists within the firm, as well as outside it. The parent company enjoys "internal" limited liability vis-à-vis the obligations of its subsidiaries, and the shareholders of the parent company enjoy "external" limited liability vis-à-vis the obligations of the parent company. The literature on limited liability has largely concentrated on external limited liability, but the policy considerations balance out very differently for internal and external limited liability.

In one of the few treatments considering both types of limited liability, Professors Henry Hansmann and Richard Squire have shown that the various positive features of limited liability are generated exclusively or primarily by external limited liability.[39] For example, internal limited liability has no impact on whether equity holders need to monitor each other, because a subsidiary is wholly owned by the parent, so there are no other shareholders to monitor. Therefore, there is no monitoring cost problem to be solved within the firm; internal limited liability has no benefit of relieving shareholders from the need to monitor each other.

Similarly, Hansmann and Squire observe, internal limited liability has no effect on share liquidity—the shares of the subsidiary do not trade in the first place. Internal limited liability simply does not further the features of the corporation that policy should encourage. Moreover, as Hansmann and Squire explain, internal limited liability tends to generate higher costs for the corporation.[40] And the practical problems of administering unlimited liability simply do not exist in the internal setting, as there is usually but a single parent of the subsidiary.

In short, the policy case for respecting internal limited liability is much weaker than that for respecting external limited liability.[41] This consideration should weigh heavily in considering the value of policies that curtail internal limited liability within banking firms.

39. *Id.* at 11.

40. *Id.* at 12.

41. *See, e.g.*, Stephen B. Presser, *Thwarting the Killing of the Corporation: Limited Liability Democracy, and Economics*, 87 NW. U. L. REV. 148, 173 (1992) (considering arguments for disregarding internal limited liability); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 111 (1985) (arguing that courts should be more willing to disregard internal limited liability than external).

B. Federal Exceptions to Limited Liability

Regardless of its desirability, limited liability is one of the bedrock principles of modern corporate law.[42] There are fissures in the corporate law Gibraltar, however. Limited liability has never been absolute. Not only is there the well-known exception of piercing the corporate veil,[43] but there are certain federal law exceptions that override state law limited liability.

For example, the Employee Retirement Income Security Act of 1974 (ERISA) provides that all affiliated companies under common control are jointly and severally liable for unfunded defined benefit pension obligations.[44] Thus, a holding company is liable for the defined benefit pension obligations of its subsidiaries. The ERISA common control liability provision covers any company with a defined benefit pension plan, which historically included many large American businesses. The likely motivation for ERISA's common control liability is to prevent the moral hazard that could result if the corporate form could be used to avoid adequate pension funding. ERISA eliminated internal limited liability only for defined benefit pension obligations, but does not disturb external limited liability.

The Internal Revenue Code also contains a functional exception to internal limited liability in respect to federal income tax obligations.[45] First, the Internal Revenue Code treats all members of a controlled group of corporations as a single taxpayer for various purposes that limit tax benefits.[46] This provision ensures that a multiplication of corporate entities is not used simply to create tax benefits. Second, the Internal Revenue Code permits, but does not require, affiliated corporations to file consolidated tax returns, creating a possibility of a voluntary waiver of limited liability.[47] Combined, however, these provisions mean that a

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42. *See, e.g.*, Easterbrook & Fischel, *supra* note 41, at 89 ("Limited liability is a fundamental principle of corporate law."); Blumberg, *supra* note 24, at 574-75 ("The limited liability of the corporate shareholder is a traditional cornerstone both in Anglo-American corporation law and in the corporation law of the civil system."); BAINBRIDGE & HENDERSON, *supra* note 26, at 2 (describing limited liability as "[t]he key feature of the corporation that makes it such an attractive form of human cooperation and collaboration"); Leebron, *supra* note 36, at 1566 ("No principle seems more established in capitalist law or more essential to the functioning of the modern economy [than the principle of limited liability].").

43. *See, e.g.,* Easterbrook & Fischel, *supra* note 41, at 89. As Robert Thompson has observed, however, veil piercing "occurs only in close corporations or within corporate groups; it does not occur in public corporations." Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1039 (1991).

44. 29 U.S.C. §§ 1301(a)(14), (b)(1), 1362(a)-(b). "Common control" is generally 80% direct or indirect ownership. 26 C.F.R. § 1.414(c)-2.

45. State income tax operates on the same principles.

46. *See, e.g.*, 26 U.S.C. §§ 179(d)(6)-(7) (placing a dollar limitation on immediate deduction of depreciable business equipment); 26 C.F.R. § 1.1561-1.

47. 26 U.S.C. §§ 1501, 1504.

controlled group of corporations (which are a subset of "affiliated" corporations) will file a joint return for which they will be jointly liable.

In contrast, under the Consumer Financial Protection Act of 2010, both internal and external limited liability is eliminated in some instances for violations of federal consumer financial law or for unfair, deceptive, or abusive acts and practices in connection with the provision of a consumer financial product or service. Liability under the Consumer Financial Protection Act attaches to "covered person[s]," a term that includes a "related person," which is in turn defined to include a "controlling shareholder" or "any shareholder…who materially participates in the conduct of the affairs of such covered person."[48] Thus, the corporate parent or individual owner of a finance company or payday lender may be co-liable with the payday lender for violations of the Consumer Financial Protection Act.[49] It seems likely that this exception to both internal and external limited liability was motivated by a concern that corporate form would be used as a liability shield in the case of small, closely-held financial services companies like many payday lenders, pawn shops, and debt collectors.

Historically, the National Bank Act imposed double liability on the shareholders of national banks: shareholders were liable for up to the par value of their shares in addition to the amount paid in for their stock.[50] Such double liability was also common for state chartered banks too, with triple liability in Colorado and unlimited liability in California.[51] Although National Bank Act double liability was typically a curtailment of external limited liability, it would, even absent fraud or other abusive conduct, pass through a BHC to its shareholders, disregarding both the BHC's internal limited liability vis-à-vis the bank and the shareholders' external limited liability vis-à-vis the BHC.[52] The federal double liability requirement was repealed in 1933 in connection with the adoption of federal deposit insurance, substituting an industry-wide mutual insurance system for bank-specific shareholder guaranties.

48. 12 U.S.C. §§ 5481(6), 5481(25), 5536. Bank holding companies, credit unions, and depository institutions are excluded from the definition of "related person." 12 U.S.C. § 5481(25).

49. Additionally, the Perishable Agricultural Commodities Act of 1930 (PACA) imposes a trust on all produce accepted by a buyer, as well as the proceeds of that produce. Under PACA, a controlling person may be liable for sales out of trust. N.P. Deoudes, Inc. v. Snyder (*In re* Snyder), 184 B.R. 473, 475 (Bankr. D. Md. 1995) (allowing for personal liability for PACA debt to be imposed on a controlling person of corporation for sale out of trust). Shareholders generally, however, face no liability under PACA, which is a very limited exception to limited liability.

50. National Bank Act of 1864, ch. 106, 13 Stat. 99, 103 June 3, 1864, § 12, *repealed by* 48 Stat. 189 (1933). Existing national banks were allowed to terminate their double liability in 1937. 49 Stat. 708 (1935).

51. John R. Vincens, *On the Demise of Double Liability of Bank Shareholders*, 12 BUS. LAW. 275 (1957) (finding that 35 states imposed some form of double liability for bank shareholders). State double liability laws were all repealed by the end of 1956. *Id.* at 276.

52. Anderson v. Abbott, 321 U.S. 349, 356-60 (1944).

What we see from the various federal exceptions to limited liability is that a surprising range of businesses—sellers of produce, non-bank finance companies, banks, and firms with defined benefit pension plans—operate or have operated without limited liability in respect to certain obligations, suggesting that limited liability is not in fact necessary to generate robust investment in these industries. Additionally, many firms across industries selectively relax limited liability as to certain contractual obligations through the issuance of downstream guaranties of their subsidiaries' obligations.

In none of these instances,[53] however, is there a complete and general loss of limited liability. Instead, limited liability is curtailed or waived only as to specific kinds of obligations or to a certain level. The controlling shareholder of a payday lender is co-liable for the payday lender's violations of federal consumer financial law, but not for a slip-and-fall on the payday lender's premises. Likewise, if a parent company guaranties a bond issued by a subsidiary, it is liable for the bond, but not for the torts committed by the subsidiary. With targeted curtailment of limited liability, the shareholder—whether a natural person or a corporation—is able to better evaluate, and potentially contract to control or insure, the particular risk for which there is no limited liability. Similarly, historical double liability for bank shareholders imposed secondary liability for all obligations of an insolvent national bank, but only at a finite level (the par value of the stock), enabling shareholders to manage the level of risk they were assuming with an investment in a bank.

The very legislation that repealed double liability for national bank shareholders planted the seeds of a new doctrine impinging on limited liability, the "source-of-strength" doctrine. The following section reviews the development of the source-of-strength doctrine up through the Dodd-Frank Act in 2010.

II. The Birth of Samson: The Development of the Source-of-Strength Doctrine

A. The Banking Act of 1933

The source-of-strength doctrine operates as a limitation on internal limited liability within banking firms. The doctrine's statutory origins are in the Banking Act of 1933,[54] the first legislation to regulate bank holding companies. The holding company was a major development of 19th-century American corporate law. A holding company is simply a compa-

53. California's unlimited liability for bank shareholders is the exception.
54. 48 Stat. 186 (June 16, 1933).

ny that owns the shares of a company—that is a parent company of a subsidiary.

Although corporate parent-subsidiary relationships are standard today, they were non-existent for most of the 19th century. By the mid-19th century, Maryland and New York had authorized corporations to own stock in other corporations, but such structures were rarely used.[55] Instead, the use of corporate holding companies took off following a set of New Jersey statutes enacted from 1888 to 1893 that not only provided clear general authority for corporations to own the stock of other corporations, but also allowed the holding company to pay for acquisitions with corporate stock.[56] The use of holding companies for banks only emerged in the 1900s, but it became more common in the late 1920s, as the affiliation of multiple banks under a holding company began to be used to avoid restrictions on interstate branching.[57]

The 1933 Banking Act required holding companies that owned shares in a member bank of the Federal Reserve System—including all federally chartered national banks[58]—to obtain a permit from the Board of Governors of the Federal Reserve System (the "Board") to vote their shares in the election of directors of the bank.[59] (Holding companies of state-chartered non-member banks were unaffected.)

The Board was to consider "the financial condition of the . . . applicant" in deciding whether to issue the permit.[60] Specifically, a permit required the applicant holding company to, *inter alia*, maintain readily marketable, unencumbered assets in an amount that stepped up to 25% of the aggregate par value of the bank stock.[61] If, however, the holding company's shareholders were "individually and severally liable in proportion" to their holdings "for all statutory liability imposed on such holding company affiliate by reason of its control of shares of stock of banks," then this liquidity requirement was reduced to 12% of the aggregate par value of the bank stock,[62] which could "be used by it for replacement of capital in banks affiliated with it and for losses incurred in such banks."[63] Left unclear was whether the liquidity requirement for holding companies

55. Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910*, 32 J. CORP. L. 323, 340-44 (2007).

56. *Id.* at 341.

57. George S. Eccles, *Registered Bank Holding Companies*, *in* THE ONE-BANK HOLDING COMPANY 82, 84-85 (Herbert V. Prochnow ed., 1969); H.R. REP. NO. 609, at 3-4, 6 (1955). National banks were forbidden to engage in branching until 1927.

58. 12 U.S.C. § 222 (requiring national banks to be members of the Federal Reserve System).

59. Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, 187.

60. *Id.* at 186.

61. *Id.*

62. *Id.*

63. *Id.*

with limited liability was to ensure the holding company's own safety-and-soundness or to provide a source-of-strength for the bank.

The 1933 Banking Act did not create a general source-of-strength requirement mandating ongoing support during the bank's lifetime and the guaranty of bank liabilities, even if the bank failed. Instead, it imposed a financial capacity requirement as a condition of allowing holding companies to vote their stock in banks' corporate elections. If a holding company of a bank did not want to vote, the conditions would not apply, enabling bank holding companies to side-step regulation,[64] which is precisely what occurred. As of 1954, only 18 of 114 known holding companies of banks had obtained voting permits from the Board.[65] It is unclear if, historically, holding companies for banks did in fact contribute to support their distressed banks and whether the FDIC, as receiver of the failed banks, had any claim on the holding company;[66] no reported decisions appear on the topic.

B. Bank Holding Company Act of 1956

The failure of the 1933 Banking Act provisions to reach most holding companies of banks led Congress to enact the Bank Holding Company Act of 1956 (BHCA).[67] The BHCA defined "bank holding companies" (BHCs)[68] and required them to obtain approval from the Board for any acquisition of additional banks and to divest of interests in most nonbanking enterprises.[69] Instead, BHCs were restricted to holding the shares and managing banks and activities incidental thereto.[70] The BHCA also imposed various restrictions on affiliate transactions for banks vis-à-vis their BHCs and other BHC affiliates.[71] In 1966, the BHCA was amended to also require Board approval for a company to become a BHC.[72]

Today, the BHCA and its implementing regulation, Regulation Y (Reg Y), continue to restrict bank affiliation with nonbanks. A BHC may itself engage in or own nonbank subsidiaries that engage in only a limited range of activities, generally incidental to the provision of banking ser-

64. H.R. REP. NO. 609, at 5 (1955).
65. *See id.* at 8.
66. Notably, the 1933 Banking Act did not apply to savings associations, only banks.
67. Pub. L. No. 84-511, ch. 240, 70 Stat. 133 (May 9, 1956).
68. BHCs were defined until 1970 as any company owning at least 25% of the shares of two or more banks. *Id.* In 1970 the BHCA definition of BHC was amended to make single bank ownership a trigger. Pub. L. No. 91-607, 84 Stat. 1760, § 101.
69. Bank Holding Company Act of 1956, Pub. L. No. 84-511, Ch. 240, 70 Stat. 134 (May 9, 1956).
70. *Id.*
71. *Id.* § 4(a)(2).
72. Pub L. No. 89-485, § 7(a).

vices.[73] These activities include acting as an investment advisor, a securities broker, a futures commission merchant, and management consultant.[74] Since 1999, if a BHC elects to be a financial holding company, then an even broader range of activities is permitted to it and its nonbank subsidiaries, including underwriting and dealing in securities, providing insurance, and limited merchant banking.[75]

There were a few separate policy motivations underlying the BHCA.[76] First was a continuing concern about the use of BHCs to end-run restrictions on interstate branching, which were understood as a competition issue.[77] Second, there were safety-and-soundness concerns. Whereas banks were restricted in their activities,[78] the only activity restriction on BHCs prior to the BHCA was a prohibition on underwriting the sale of securities.[79] Thus, prior to the BHCA, BHCs enabled banks to affiliate with nonbanks engaged in all other manner of commercial activity. This raised the concern that the bank would be used as a captive lender to finance its affiliates' commercial activities, even at non-arm's-length terms, thereby endangering the safety-and-soundness of the bank. And third, such captive, subsidized financing also produced competition policy concerns for the markets of the affiliates' commercial activities.

The BHCA section 3(c)(2), the provision mandating Board approval for a company to become a BHC or for an existing BHC to acquire a bank, provides that the Board "shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned" when considering an application to become a BHC or for a BHC to acquire a bank.[80]

The financial resources of a company seeking to become a BHC (or of a BHC seeking to expand its holdings) would be relevant to approval of the application only if there were either (1) a concern that the BHC would prop up itself or a nonbank affiliate at the expense of the bank or (2) an expectation that the bank could draw on those resources. The legislative history of the BHCA indicates a concern only about the former scenario, not the latter. The BHCA legislative history discusses examples

73. 12 U.S.C. § 1843; 12 C.F.R. §§ 225.22, 225.28. In 1997, Reg Y was amended to require a pushout of futures commission merchant activities to a subsidiary. 62 Fed. Reg. 9290, 9309 (Feb. 28, 1997) (codified at 12 C.F.R. § 225.28(b)(8)(ii)).

74. 12 C.F.R. § 225.28(6)(b).

75. 12 U.S.C. § 1843(k)(4)(B), (E), (H), (I).

76. Saule Omarova & Meg Tahyar, *That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulations in the United States*, 31 ANN. REV. BANKING & FIN. L. 113, 120-24 (2011-12).

77. *Transamerica—The Bankholding Company Problem*, 1 STAN. L. REV. 658, 661-64 (1949).

78. 12 U.S.C. § 24(7).

79. S. REP. NO. 300, 80th Cong. 1st Sess. 2 (1947); 12 U.S.C. § 61(e) (1946).

80. 12 U.S.C. § 1842(c)(2).

of BHCs looting their banks.[81] It contains no mention about the failure of BHCs to support troubled banks. Accordingly, the BHCA contains restrictions on bank transactions with affiliates,[82] a provision meant to address the former concern, but the BHCA has no language mandating financial support from the holding company to the bank, much less in a particular amount or circumstances.

Nevertheless, the Board at times denied applications to become a BHC based on the applicant's financial condition, noting in one order that BHCA section 3(c)(2) required it to consider the ability of an applicant to "serve, when and as required, as a source of financial assistance to its subsidiary banks," a phrase not itself found in the statute.[83] Accordingly, the Board routinely considered the financial condition of the applicant in its decisions.[84] Yet it varied in whether it cast the concern as being the ability of the holding company to support the bank[85] or the possibility that the bank would end up supporting the holding company.[86] Moreover, the Board only considered the financial condition of the BHC in regard to BHC applications; the Board never contended that post-application there was an ongoing financial obligation for a BHC to support its bank

81. H.R. REP. NO. 609, 84th Cong., 1st Sess., at 4-5 (1955).

82. 12 U.S.C. § 371c.

83. *Mid-Continent Bancorporation*, 52 FED. RSRV. BULL. 198, 200 (1966).

84. *Cf. Midwest Bancorporation*, 56 FED. RSRV. BULL. 948, 950 (1970) (finding that acquisition debt "would hinder [Applicant's] ability to meet emergency capital needs of its subsidiary banks should such need arise"); *Seilon, Inc.*, 58 FED. RSRV. BULL. 729, 730 (1972) (finding that acquisition would have positioned the applicant "to improve its [weak] financial condition at the expense of [the one-bank holding company proposed to be acquired] through liberal or excessive dividends or management fees drawn from [b]ank"); *Bankshares of Hawley*, 62 FED. RSRV. BULL. 610, 611 (1976) ("servicing of Applicant's substantial acquisition debt over a 12-year period through Bank's dividends can be expected to further weaken Bank's capital position"), *with First Southwest Bancorporation*, 58 FED. RSRV. BULL. 301, 302 (1972) ("[t]he Board believes that a holding company should be a source of financial and managerial strength for the banks in its system, rather than vice versa"); *Downs Bancshares*, 61 FED. RSRV. BULL. 673, 674 (1975) ("[t]he Board has indicated on previous occasions that it believes that a holding company should provide a source of financial and managerial strength to its subsidiary bank(s)").

85. *See, e.g.*, *Midwest Bancorporation*, *supra* note 84, at 950 (finding that acquisition debt "would hinder [Applicant's] ability to meet emergency capital needs of its subsidiary banks should such need arise"); *Downs Bancshares*, *supra* note 84, at 674 ("[t]he Board has indicated on previous occasions that it believes that a holding company should provide a source of financial and managerial strength to its subsidiary bank(s)"); *Citizens Bancorp*, 61 FED. RSRV. BULL. 806 (1975) (denying BHC application based on proposed BHC's debt load to be serviced with dividends from the bank because it might "impair Bank's overall ability to continue to serve the community as a viable banking organization."); *One Corporation*, 61 FED. RSRV. BULL. 671 (1975) (denying BHC application because the applicant's "debt retirement program, which contemplates significant dividends from Bank, does not provide Applicant with the necessary financial flexibility to service the acquisition debt while maintaining Bank's capital at an acceptable level.").

86. *See, e.g.*, *Seilon, Inc., supra* note 84, at 730 (acquisition would have positioned the applicant "to improve its [weak] financial condition at the expense of [the one-bank holding company proposed to be acquired] through liberal or excessive dividends or management fees drawn from [b]ank"); *Bankshares of Hawley*, *supra* note 84, at 611 ("servicing of Applicant's substantial acquisition debt over a 12-year period through Bank's dividends can be expected to further weaken Bank's capital position").

or pay for the bank's obligations, except to the extent that there was specific agreement to do so.[87]

In 1978, the Supreme Court upheld the Board's authority to consider the financial and managerial condition of a BHC applicant, irrespective of the effect of the transaction.[88] The Court's ruling did not, however, address whether the source-of-strength doctrine had any relevance other than in the BHC application process or whether the purpose of the doctrine was to avoid bank entanglements with the BHC or to ensure a BHC backstop of the bank.

C. Federal Reserve Board Regulation Y

In 1984, as part of the revisions of Reg Y, which implements the BHCA, the Board added a regulatory source-of-strength provision: "A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner."[89] The preamble to the proposed version of the rule stated that it was merely a codification of existing Board policy.[90] Yet there is a marked difference between consideration of the financial condition of a company in the context of a BHC application—a snapshot at a particular moment in time—and an ongoing requirement of providing financial support to a subsidiary as implied by Reg Y.

Thus, while Reg Y was supposedly grounded in BHCA section 3(c)(2), regarding application to become a BHC, it was also tied to the Board's authority to issue cease-and-desist orders for unsafe and unsound banking practices.[91] Failure of a BHC to provide ongoing support to a subsidiary had never previously been treated as an unsafe and unsound banking practice, however, and the Board provided no explanation of why it would be for a BHC, but not for direct shareholders of a bank without a BHC.[92] Given the injunctive nature of the cease-and-desist remedy, however, a safety-and-soundness violation would either be moot because the bank would have already failed, or a self-fulfilling prophecy,

87. *Northern States Financial Corp.*, 58 FED. RSRV. BULL. 827, 828 (1972) ("a holding company should agree to strengthen the capital position of each of its subsidiaries to a desirable level as a condition to Board approval of the bank holding company formation or expansion.").

88. Bd. of Governors. of the Fed. Rsrv. Sys. v. First Lincolnwood Corp., 439 U.S. 234, 249-53 (1978).

89. Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. 794, 820 (Jan. 5, 1984) (codified at 12 C.F.R. § 225.4).

90. Bank Holding Companies and Change in Bank Control; Proposed Revision of Regulation Y, 48 Fed. Reg. 23520, 23523 (1983).

91. *Id.*

92. This is not to say that such explanations do not exist. *See, e.g.*, Keeton, *supra* note 7; Helen A. Garten, *Subtle Hazards, Financial Risks, and Diversified Banks: An Essay on the Perils of Regulatory Reform*, 49 MD. L. REV. 314, 353 (1990).

with the bank's failure to follow shortly after such order, which would undermine customer and counterparty confidence.

The Board put the new regulation into action in 1987, when it issued a cease-and-desist order against Hawkeye Bancorp, a multibank holding company that the Board alleged was engaged in an unsafe and unsound banking practice by refusing to contribute capital to a failing bank subsidiary.[93] The Board withdrew its order after the bank was closed by the state banking supervisor,[94] but the order sent a signal that the Board viewed failure of a BHC to support a distressed subsidiary as itself an unsafe and unsound practice, a broader interpretation of source-of-strength than had previously been seen.

The Board made this signal clearer later that year by issuing a policy statement that reaffirmed that a BHC must serve as a source of strength to its bank subsidiaries:

> 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.[95]

Therefore, the Board concluded as follows:

> a bank 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 the support. A bank holding company's failure to assist a troubled or failing subsidiary bank under these circumstances would generally be viewed as an unsafe and unsound banking practice or a violation of Regulation Y or both.[96]

In 1988, the Board issued a cease-and-desist order against MCorp, a BHC it alleged was engaged in unsafe and unsound banking practices "likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for its" subsidiary banks.[97] The Board sought to require MCorp to implement a

93. *Fed Disciplines Financially Strapped BHC for Failure to Bail Out Ailing Subsidiary*, 48 BANKING REP. (BNA) 297 (Feb. 16, 1987).

94. Lisabeth Weiner, *Fed Drops Case Against Hawkeye*, AM. BANKER, May 1, 1987, at 11.

95. Policy Statement; Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks, 52 Fed. Reg. 15707, 15707.

96. *Id.* at 15708.

97. MCorp Fin. v. Bd. of Governors of the Fed. Rsrv. Sys., 900 F.2d 852, 853 (5th Cir. 1990), *aff'd in part, rev'd in part*, 502 U.S. 32 (1991).

plan for recapitalizing the subsidiary banks.[98] MCorp subsequently filed for Chapter 11 bankruptcy and sought to enjoin the Board from proceeding against it administratively.[99]

The Fifth Circuit Court of Appeals held that the Board lacked the authority under the BHCA or other statutes to promulgate source-of-strength doctrine,[100] but the Supreme Court subsequently reversed on the grounds that there was no jurisdiction to enjoin the Board's regulatory proceedings.[101] There was never any definitive judicial ruling in the MCorp litigation on the legitimacy or meaning of the source-of-strength doctrine.[102] The Board, however, terminated its cease-and-desist order only after MCorp made an additional capital contribution to its remaining subsidiary banks.[103]

Reg Y remained unchanged in regard to source-of-strength until 1997, when the Board amended it to require that BHCs conduct their futures commission merchant activities through a separate subsidiary, rather than through the BHC.[104] This change was undertaken "to limit the bank holding company's exposure to contingent obligations under the loss sharing rules of exchange clearinghouses in order to preserve the holding company's ability to serve as a source of strength to its subsidiary insured depository institutions."[105] Notably, BHCs were not required to push out other proprietary trading, including in foreign exchange or cash-settled derivatives.[106] Although this change imposed a structural requirement designed to ensure that the BHC would not be a "source of weakness" for its bank subsidiary, it did not impose any affirmative, actionable requirement for a BHC to actually support its bank subsidiaries. Instead, the doctrine remained confined to the cryptic statement in Reg Y and the Board's on-the-ground interpretation thereof.

D. FDIA Cross-Guaranty Provision

Even as the MCorp litigation was working its way through the courts, Congress passed the Financial Institutions Reform, Recovery, and

98. *Id.*

99. *Id.* at 854.

100. *Id.* at 853.

101. 502 U.S. 32, 34 (1991).

102. Similarly, in the case of the Bank of New England Corporation, the Board, FDIC, and OCC compelled the BHC under the source-of-strength doctrine to transfer over $500 million to its bank subsidiary prior to the receivership of the subsidiary. *See supra* note 9. The trustee in the BHC's bankruptcy sued to avoid the transfers as fraudulent transfers, resulting in a settlement of $140 million. *Id.*

103. *In re* MCorp, Bd. of Governors of Fed. Rsrv. Sys., Docket No. 88-062-B-A2-HC; 88-062-C1-HC; 88-062-C2-HC; and 88-062-C3-HC (June 15, 1992).

104. 62 Fed. Reg. 9290, 9309 (Feb. 28, 1997) (codified at 12 C.F.R. § 225.28(b)(7)(iv)).

105. *Id.*

106. 12 C.F.R. § 225.28(b)(8)(ii).

Enforcement Act of 1989.[107] This legislation, passed in response to the S&L crisis, amended the Federal Deposit Insurance Act (FDIA) by adding a "cross-guaranty" provision that makes insured depository institutions liable for any loss incurred by or reasonably anticipated to be incurred by the FDIC in connection with the default or rescue of a commonly controlled insured depository institution.[108] In other words, banks that are under common control now cross-guaranty each other's liabilities to the FDIC—basically the insured deposit liabilities. This means that if a BHC owns multiple banks, each of the bank subsidiaries guaranties all of the others' liability to the FDIC. The cross-guaranty liability has statutory priority over any claim on the guarantor from its shareholder or other affiliate.[109]

Thus, from the perspective of the FDIC, there is a consolidation of the assets of affiliated banks. The FDIA cross-guaranty provision does not directly reach the BHC or any nonbank affiliates, however.[110] If there were a securities or insurance affiliate, neither would be liable for the bank's obligations by way of the FDIA. The FDIA cross-guaranty provision is, at best, source-of-strength lite.

E. 1990 Bankruptcy Code Amendments

In 1990, Congress amended the Bankruptcy Code to enact two linked provisions addressing the treatment of pre-bankruptcy commitments given by debtors to federal bank regulators to maintain the capital of insured depository institutions.[111] When a bank is identified by regulators as being in trouble, regulators will often attempt to get the BHC or other affiliates to commit to providing capital support for the bank. These commitments are generally referred to as capital and liquidity maintenance agreements (CALMAs).

BHCs are motivated to enter into CALMAs with the Board and sometimes other regulators in order to stave off regulatory action against the bank, such as the triggering of an FDIC receivership. A BHC would only be so motivated, however, if it thought that the bank remained potentially valuable. If the bank were deeply insolvent, the BHC would be reluctant to throw good money after bad.

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107. Pub. L. No. 101-73, 103 Stat. 183 (1989).

108. 12 U.S.C. § 1815(e)(1)(A). Notably, the FDIA cross-guaranty provision has no purchase until and unless there is a bank failure; in contrast, the source-of-strength doctrine seems to have more bite before a bank fails than after.

109. 12 U.S.C. § 1815(e)(2)(C).

110. Professor Howell Jackson has rightly noted, however, that "[w]hen the FDIC levies assessments against affiliated institutions, the cross-guarantee provision effectively dilutes a holding company's investment in those affiliates and thereby depletes its resources." Jackson, *supra* note at 7, at 537.

111. Pub. L. No. 101-647, § 2522, 104 Stat. 4859, 4866.

Bank regulators wanted the 1990 bankruptcy amendments because when banks failed, their BHCs would then file for bankruptcy and reject their obligations under CALMAs as executory contracts. The bank regulators would then be left with general unsecured prepetition claims in the BHC's bankruptcy, ranking equally with the BHC's bondholders and vendors, and sharing whatever assets the BHC had on a pro-rated basis.[112] The 1990 amendments to the Bankruptcy Code were designed to prevent parties affiliated with banks (primarily BHCs) from "using bankruptcy to evade commitments to maintain capital reserve requirements of a Federally insured depository institution."[113]

The 1990 bankruptcy amendments did this through two provisions. First, subsection 365(o) was added to the section of the Bankruptcy Code dealing with executory contracts and unexpired leases:

> In a case under chapter 11 of this title, the trustee shall be deemed to have assumed (consistent with the debtor's other obligations under section 507), and shall immediately cure any deficit under any commitment by the debtor to the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Director of the Office of Thrift Supervision, the Comptroller of the Currency, or the Board of Governors of the Federal Reserve System, or its predecessors or successors, to maintain the capital of an insured depository institution, and any claim for a subsequent breach of the obligations thereunder shall be entitled to priority under section 507.[114]

Chapter 11 is the preferred filing chapter for businesses of any size even if the business is liquidating because management generally retains control of the company and the bankruptcy process, as well as attorney-client privilege.

Normally, debtors have a choice regarding treatment of executory contracts, that is contracts that with material obligations owing from both parties.[115] A debtor may either assume an executory contract or reject it.[116] If the debtor assumes an executory contract, the debtor' must perform the contract. If it subsequently breaches, the post-assumption damages will be treated as administrative expenses of the bankruptcy, which must be paid in full, in cash, on the effective date of a plan.[117] If the debt-

112. 11 U.S.C. §§ 365(g)(1); 726(a)(2), 1129(a)(7).

113. H.R. REP. NO. 681(I), 101st Cong., 2d Sess., at 179 (1990), *as reprinted in* 1990 U.S.C.C.A.N. 6472, 6585.

114. Crime Control Act of 1990, § 2522(c), Pub. L. No. 101-647, 104 Stat. 4866 (Nov. 29, 1990) (codified at 11 U.S.C. § 365(o)).

115. Vern Q. Countryman, *Executory Contracts in Bankruptcy: Part 1*, 57 MINN. L. REV. 439, 450 (1973) (providing the most commonly used definition for the Bankruptcy Code's undefined term "executory contract").

116. 11 U.S.C. § 365(a).

117. *See* 11 U.S.C. §§ 503(b)(1), 507(a)(2), 1129(a)(9).

or rejects an executory contract, the contract is treated as having been breached by the debtor immediately prior to the filing of the bankruptcy, resulting in a general unsecured claim).[118]

Section 365(o) denies BHC debtors this choice regarding CALMAs if they wish to remain in Chapter 11. Instead, they are deemed to assume the CALMA and are required to cure any deficit thereunder.[119]

Thus, there is no choice of rejection in Chapter 11.[120] Instead, if a debtor does not wish to comply with a CALMA, it must convert its case to Chapter 7, where it will be liquidated by an independent trustee in bankruptcy. The trustee can and will reject the CALMA as a regular executory contract in Chapter 7, but that is where the second provision added by the 1990 bankruptcy amendments comes into play.

That provision, currently codified as section 507(a)(9) of the Bankruptcy Code, created an additional statutory priority for:

> allowed unsecured claims based upon any commitment by the debtor to Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Director of the Office of Thrift Supervision, the Comptroller of the Currency, or the Board of Governors of the Federal Reserve System, or their predecessors or successors, to maintain the capital of an insured depository institution.[121]

In a liquidation in Chapter 7, priority claims are paid out ahead of general unsecured claims.[122] Section 507(a)(9) thus gives the CALMA claims of bank regulators on the BHC priority over general unsecured claims—such as those of the BHC's bondholders.[123] Yet priority claims are themselves paid out in a sequence based on their priority level, starting with 507(a)(1), then 507(a)(2), and so forth.[124] By giving the capital maintenance commitment a 507(a)(9) priority, it was placed behind both the administrative expenses of the bankruptcy (currently under section

118. *See* 11 U.S.C. § 365(g)(1).

119. Resolution Trust Corp. v. Firstcorp (*In re* Firstcorp), 973 F.2d 243, 248 (4th Cir. 1992). Given that a CALMA might have a schedule for improving the bank's capital adequacy, the deficit would, presumably mean amounts already due, but not the total balance.

120. The debtor could still breach an assumed CALMA. Doing so would buy a debtor some time, but the debtor could not emerge from Chapter 11 without paying the equivalent amount for the breach as it would have to honor the commitment.

121. Crime Control Act of 1990, § 2522(d), Pub. L. No. 101-647, 104 Stat. 4867 (Nov. 29, 1990) (codified currently at 11 U.S.C. § 11 U.S.C. § 507(a)(9)).

122. 11 U.S.C. § 726(a)(1)-(2).

123. Such priority is binding in a Chapter 7 liquidation, and absent the regulatory agency's consent, a Chapter 11 plan cannot be confirmed if it does not pay the agency at least as much as it would have received in a Chapter 7 liquidation for the claim. 11 U.S.C. § 1129(a)(7).

124. 11 U.S.C. § 726(a)(1).

507(a)(2)) and priority tax claims (currently under section 507(a)(8)).[125] The placement of CALMA claims behind the administrative expenses and priority tax claims greatly reduces the chance of there being any recovery on the CALMA claims.[126]

A 1994 technical amendment to the Bankruptcy Code replaced the laundry list of federal banking regulators that appeared in sections 365(o) and 507(a)(9) with the phrase "a Federal depository institutions regulatory agency (or predecessor to such agency)."[127] That phrase had already been defined in the 1990 bankruptcy amendments as referring, for a bank not in conservatorship or receivership, to "the appropriate Federal banking agency" as defined in the Federal Deposit Insurance Act.[128]

Although the change was supposed to be technical, it was eventful; based on the revised definition, the bankruptcy court in Colonial BancGroup's bankruptcy held that a CALMA between the BHC and the Federal Reserve Board as the regulator of the BHC did not trigger either section 365(o) or 507(a)(9) because the FDIC, not the Board, was the regulator of the bank.[129] The court also held that the CALMA was not definite enough to trigger section 365(o).[130]

Although the Colonial BancGroup litigation settled while the ruling was on appeal, it is abundantly clear from the legislative history of sections 365(o) and 507(a)(9) that the bankruptcy court erred and that a CALMA with any federal banking regulator would trigger those sections.

125. Even if the debtor fails to cure and converts to a Chapter 7 case, the priority of the capital commitment claim remains under 507(a)(9), not 507(a)(2). Wolkowitz v. FDIC (*In re* Imperial Credit Indus.), 527 F.3d 959, 976 (9th Cir. 2008).

126. Yet if the debtor stays in Chapter 11, any cure payment made would in fact temporally leapfrog the 507(a)(1) through 507(a)(8) priorities because they would be paid in full immediately, while other priority claims would only be paid on the effective date of a plan or thereafter, and would risk a future conversion or dismissal of the case. 11 U.S.C. § 1129(a)(9). *See* Resolution Trust Corp. v. Firstcorp (*In re* Firstcorp), 973 F.2d 243, 247-48 (4th Cir. 1992) (rejecting priority skipping argument). *But see In re* Colonial BancGroup, Inc., 436 B.R. 713, 730-33 (Bankr. M.D. Ala. 2010) (noting that capital maintenance commitment that cannot be assumed and cured because bank is no longer operating is not covered by section 365(o) because it would have the effect of skipping priorities).

127. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4145 § 501(d)(11) (other technical amendments).

128. Crime Control Act of 1990, § 2522(e)(4), Pub. L. No. 101-647, 104 Stat. 4867 (Nov. 29, 1990) (codified currently at 11 U.S.C. § 101(21B)).

129. *In re* Colonial BancGroup, Inc., 436 B.R. 713, 735-36 (Bankr. M.D. Ala. 2010) (declining to apply section 365(o) to a capital maintenance agreement between a BHC and the Board when the bank's primary regulator was the FDIC). The court declined to rule on the related issue of whether the FDIC had standing to enforce a capital maintenance agreement made with the Board to which the bank was not a party.

130. Ambiguity about whether there was actually a capital maintenance commitment also defeated the FDIC's claim in Amtrust Financial Corporations' bankruptcy. FDIC v. Amtrust Fin. Corp. (*In re* Amtrust Fin. Corp.), 694 F.3d 741 (6th Cir. 2012).

Nevertheless, the bankruptcy court's opinion in *Colonial BancGroup* remains a potential hindrance to future attempts to enforce CALMAs.[131]

The inclusion of the deemed assumption provision within the section of the Bankruptcy Code dealing with executory contracts and leases underscores the plain language of both provisions, namely that they are limited to actual capital maintenance *agreements* with rather than creating a free-standing obligation of capital support.[132] In other words, the Bankruptcy Code provisions are only triggered if there is a *contractual* capital maintenance commitment in place; they are not a backdoor source-of-strength doctrine that create obligations for the BHC. Left unanswered is whether the source-of-strength doctrine as expressed in Reg Y creates liability by itself or if the doctrine is only a general principle requiring contractual implementation for liability to attach to a BHC.

F. FDICIA Prompt Corrective Action

The year after the Bankruptcy Code amendments, in further response to the S&L crisis, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which amended the FDIA to include the "prompt corrective action" system.[133] Under this system, if a bank is undercapitalized, regulators can issue a "prompt corrective action" order for the bank to submit an acceptable capital restoration plan to its regulator. An acceptable plan requires the BHC to guaranty that the bank will comply with the plan until the bank is adequately capitalized for one year, including providing "appropriate guaranties of performance."[134]

The prompt corrective action system does not require that the BHC actually guaranty the adequate capitalization of the subsidiary. Instead, it merely provides that such a guaranty is a requirement for federal regula-

131. One is tempted to see the lesson from *Colonial BancGroup*, as one of lawyering: had (1) the CALMA been drafted with greater specificity and (2) the FDIC been a party to the CALMA, then the result would have been different. But even if the case had been lawyered differently, a problem would still exist: the debtor would likely have converted to Chapter 7, and any recovery on the CALMA claim would go to either the Board and thus ultimately into Treasury, 12 U.S.C. § 289(a)(3)(B), or to the FDIC as a government corporation rather than going to offset the losses incurred by the FDIC's Deposit Insurance Fund, which is a private, mutual insurance fund, and not part of the federal budget.

132. This means, among other things, that there will be a factual question before the bankruptcy court about whether there was in fact a capital maintenance commitment, and generalized promises to "assist" a subsidiary bank will be insufficient. *In re* Colonial BancGroup, Inc., 436 B.R. 713, 730-33 (Bankr. M.D. Ala. 2010). Additionally, the capital maintenance commitment must be to "a Federal depository institutions regulatory agency"—that is the regulator of the bank, rather than of the BHC, in order to trigger Bankruptcy Code section 365(o). *Id.* at 735-36. *But see In re* Overland Park Fin. Corp., 232 B.R. 215 (D. Kan. 1999), *aff'd* 236 F.3d 1246 (10th Cir. 2001) (finding that "informal" net worth stipulation was a capital maintenance commitment).

133. Pub. L. No. 102-242, 105 Stat. 2236 (1991) (codified at 12 U.S.C. § 1831o).

134. 12 U.S.C. § 1831o(e)(2)(C)(ii).

tors to find that the plan is acceptable. The BHC is not required to guaranty the capitalization. If it does not, the bank might end up in receivership, but the BHC will not be liable under the prompt corrective action regime.[135] Moreover, even if the BHC does guaranty adequate capitalization, that guaranty is limited to the lesser of the amount by which the bank is undercapitalized or 5% of the bank's total assets when it became undercapitalized.[136]

The prompt corrective action system is a far cry from a full-blown source-of-strength doctrine. It merely allows federal regulatory agencies to force the BHC to decide if it wants to put more resources into the bank or not. If the BHC declines to comply with the prompt corrective action order, then regulators can shut down the bank, but at no point does it impose an obligation on the BHC without the BHC's consent. Given that the bank is likely to be important to the BHC's ongoing business overall, a BHC is likely to comply with a prompt corrective action order, if it can.[137] But not all BHCs will be in a position to comply, and even if they can, the BHC might well decide that the bank is too deeply insolvent and decline to throw good money after bad, but instead to preserve its assets for the benefit of its creditors and shareholders.

III. Samson, Shorn: Source-of-Strength in Action During the 2008 Crisis

The fallout of the 2008 financial crisis presented several tests of the source-of-strength doctrine. Following the three largest bank failures during the 2008 crisis—those of Washington Mutual Bank, IndyMac FSB, and Colonial Bank—the BHCs for each of the failed banks filed for bankruptcy. In the BHCs' bankruptcies, the FDIC, as receiver for the bank, filed proofs of claim, seeking to recover from the BHCs on various grounds, including source-of-strength. It is unclear if the FDIC pursued source-of-strength claims against the BHCs of smaller failed banks; the BHCs of smaller banks frequently liquidate outside of bankruptcy in procedures like assignments for the benefit of creditors, where claims records are not readily accessible. This Part reviews the three major BHC bankruptcies where the FDIC sought to recover on the basis of source-of-strength. The picture it paints is of a completely ineffective doctrine that has resulted in virtually no recovery for the FDIC.

135. *See id.* § 1831o(e)(2)(E)(ii)(I)-(II).

136. *Id.* § 1831o(e)(2)(E)(i).

137. The Federal Deposit Insurance Act's cross-guaranty requirement, 12 U.S.C. § 1815(e)(1)(A), means that BHCs with multiple subsidiary banks cannot cut one troubled bank subsidiary loose; instead, the subsidiaries all rise and fall together.

A. *IndyMac Bancorp, Inc.*

The FDIC took IndyMac FSB into conservatorship on July 11, 2008.[138] It was, at the time, the third largest bank failure (in nominal asset terms) in U.S. history.[139] On July 31, 2008, IndyMac Bancorp, Inc., the bank holding company for IndyMac FSB, filed for Chapter 7 bankruptcy.[140] The FDIC filed a proof of claim for over $5 billion dollars in the BHC's bankruptcy.[141] The claim was based on capital maintenance, fraudulent transfers (primarily dividends), tort claims for breach of fiduciary duty, and alleged ownership of a tax refund that had gone to the BHC.[142] The capital maintenance obligation claim was not based on a particular agreement, but on a general obligation to maintain capital, that is source-of-strength. The FDIC also alleged that all of the $5 billion claim was a priority claim under section 507(a)(9).[143] If the claim were to have been allowed in full as a priority claim, there would not have been any assets available for distribution to the BHC's general unsecured creditors.[144]

The trustee in the BHC's bankruptcy commenced an adversary proceeding objecting to IndyMac's proof of claim.[145] Several years of litigation followed, primarily focused on the ownership of the tax refund, with the BHC prevailing on the ownership issue before settling with the FDIC.[146] The settlement, which was approved by the bankruptcy court,[147]

138. *Failed Bank Information: Information for IndyMac Bank, F.S.B., and IndyMac Federal Bank, F.S.B., Pasadena, CA*, FDIC (Sept. 10, 2020), https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/indymac.html#Possible%20Claims%20Against%20The%20Failed%20Institution [https://perma.cc/NEM8-4486].

139. In inflation adjusted terms, IndyMac's assets were the sixth largest at the time.

140. Petition, *In re* IndyMac Bancorp, Inc., No. 2:08-bk-21752 (Bankr. C.D. Cal. July 31, 2008).

141. FDIC Proof of Claim, *In re* IndyMac Bancorp, Inc. No. 2:08-bk-21752 (Bankr. C.D. Cal.), *available as* Attachment B to First Amended Complaint: (1) Objecting to FDIC Claim; (2) For Subordination of FDIC Claim; (3) Counterclaim for Declaratory Relief, Adv. Proc. No. 2:09-ap-01698-BB (Bankr. C.D. Cal. Apr. 19, 2011) (seeking in excess of $5 billion for capital maintenance obligation violations).

142. *Id.*

143. *Id.* This suggests that the entire claim was in fact for capital maintenance.

144. Motion for Order Approving Settlement Agreement by and Between the Trustee and the Federal Deposit Insurance Corporation; Memorandum of Points and Authorities; Declaration of Alfred H. Siegel in Support Thereof 9, No. 2:08-bk-21752 (Bankr. C.D. Cal. Nov. 5, 2014) (Dkt. No. 865).

145. First Amended Complaint: (1) Objecting to FDIC Claim; (2) For Subordination of FDIC Claim; (3) Counterclaim for Declaratory Relief, Adv. Proc. No. 2:09-ap-01698-BB (Bankr. C.D. Cal. Apr. 19, 2011).

146. Memorandum, FDIC v. Siegel (In the Matter of IndyMac Bancorp, Inc.), No. 12-56218 (9th Cir. Apr. 21, 2014) (affirming judgment for IndyMac Bancorp, Inc. regarding ownership of over $55 million in tax refunds).

147. Order Granting Motion for Order Approving Settlement Agreement by and Between the Trustee and the Federal Deposit Insurance Corporation, No. 2:08-bk-21752 (Bankr. C.D. Cal. Dec. 3, 2014) (Dkt. No. 898).

provided that the FDIC would have an allowed unsecured bankruptcy claim of $58.4 million, representing the tax refunds that had been ruled to be property of the BHC.[148] Given that the FDIC had already lost a final judgment on the tax refund ownership, this $58.4 million is best seen as representing a settlement of its capital maintenance, fraudulent transfer, and tort claims for approximately a penny on the dollar.

The $58.4 million was not, however, what the FDIC got paid in the end. Although the FDIC's claim was *allowed* for $58.4 million, the BHC's insolvency mean that it only received a distribution on the claims of about $5.6 million.[149] In other words, the FDIC's ultimate recovery was only 0.1% of originally asserted claim.

Although there was never any court ruling on the capital maintenance obligation claims in *IndyMac Bancorp, Inc.*, the fact that the FDIC was willing to settle for such a pittance—and the time and funds it spent litigating the much smaller tax refund issue—suggests that the FDIC did not believe that it had a strong case on the capital maintenance obligation claims.

B. Washington Mutual, Inc.

Washington Mutual Bank was the largest bank to fail in U.S. history.[150] Like IndyMac FSB, Washington Mutual Bank failed with the collapse of the housing market in the United States. On September 25, 2008, the FDIC was appointed as receiver of Washington Mutual Bank.[151] The FDIC immediately sold substantially all of Washington Mutual Bank's assets and liabilities to JPMorgan Chase Bank, N.A.[152] The BHC, Washington Mutual, Inc., (WMI), filed for Chapter 11 bankruptcy the next day.[153]

The FDIC, as receiver of Washington Mutual Bank, filed a proof of claim against WMI.[154] The FDIC's claim was based on a range of underly-

148. Motion for Order Approving Settlement Agreement by and Between the Trustee and the Federal Deposit Insurance Corporation; Memorandum of Points and Authorities; Declaration of Alfred H. Siegel in Support Thereof 7, No. 2:08-bk-21752 (Bankr. C.D. Cal. Nov. 5, 2014) (Dkt. No. 865).

149. Chapter 7 Trustee's Final Account and Distribution Report Certification that the Estate Has Been Fully Administered and Application to Be Discharged (TDR) 25, *In re: IndyMac Bancorp, Inc.*, No. 2:08-bk-21752 (Bankr. C.D. Cal. Feb. 4, 2020) (Dkt. No. 1070) (claims allowed of $58,360,874,19 and claims paid of $5,637,618.13).

150. *Status of Washington Mutual Bank Receivership*, FDIC (Oct. 23, 2020) https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/wamu-settlement.html [https://perma.cc/U9HB-9LEG].

151. *Id.*

152. *Id.*

153. Petition, *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Sept. 26, 2008) (Dkt. No. 1).

154. Proof of Claim No. 2140, *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Sept. 26, 2008).

ing issues, including ownership of tax-related items, obligations under an agreement with the Office of Thrift Supervision relating to the sale of trust preferred securities, fraudulent transfer claims, and capital maintenance obligations.[155] The FDIC did not cite to any general capital maintenance agreement, only to a specific one relating to the sale of trust preferred securities. The capital maintenance obligation claim—and the claim in general—was for an unliquidated amount,[156] but there were dollar figures for individual parts of the claim. The tax related items alone were for over $4 billion.[157]

WMI never filed an objection to the proof of claim. Instead, it engaged in litigation with the FDIC in a number of forums about various issues in the proof of claim, but never regarding the capital maintenance obligation element. The FDIC's claim against WMI was only one piece in a thicket of litigation among WMI, JPMorgan Chase, the FDIC in its capacity as receiver for Washington Mutual Bank, and the FDIC in its corporate capacity, "with each asserting Claims for billions of dollars against one or more of the others in various forums each of the parties contended had jurisdiction over the issues."[158]

In May 2010, the FDIC settled with WMI and JPMorgan Chase.[159] The settlement, which was incorporated into WMI's Chapter 11 plan, was confirmed by the bankruptcy court in February 2012.[160] The settlement provided that the FDIC would withdraw its proof of claim in exchange for releases from WMI and a share of the tax refunds owed to WMI.[161] The FDIC's share of the tax refund resulted in a recovery of $843.9 million for the FDIC as receiver for the bank.[162]

It appears that neither the FDIC nor WMI ever took the capital maintenance component of the claim seriously and that its inclusion in the FDIC's proof of claim was more by way of a reservation of rights than an actual claim for damages. The doctrine was not even invoked by name in the FDIC's proof of claim, and there is no mention anywhere in the WMI docket of the capital maintenance issue; the issue appears solely in three paragraphs in FDIC's 57-paragraph claim. The source-of-strength

155. *Id.*

156. *Id.* at 11.

157. *Id.* at 3.

158. Disclosure Statement for the Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code, *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Dec. 12, 2011) (Dkt. No. 9179) at 17.

159. *Status of Washington Mutual Bank Receivership*, *supra* note 150.

160. *Id.*

161. Disclosure Statement for the Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code, *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Dec. 12, 2011) (Dkt. No. 9179) at 90, 93.

162. *Status of Washington Mutual Bank Receivership*, *supra* note 150.

doctrine, "the *summa theologica* of bank regulation,"[163] had no observable impact in the largest bank failure in U.S. history.

C. The Colonial BancGroup, Inc.

On August 14, 2009, Alabama regulators closed Colonial Bank in Montgomery, Alabama, and appointed the FDIC as receiver.[164] At the time of its failure, Colonial was the sixth largest U.S. bank failure ever.[165] Shortly thereafter, on August 25, 2009, Colonial Bank's BHC, Colonial BancGroup, Inc., filed for bankruptcy in the Middle District of Alabama.[166]

In January 2009, Colonial BancGroup had entered into an agreement with the Federal Reserve Bank of Atlanta and the Alabama State Banking Department to "utilize its financial . . . resources" to ensure that Colonial Bank complied with its own memorandum of understanding with the regulators regarding its own capitalization.[167] Colonial Bank never cured the deficiency in its own capitalization prior to its receivership.[168] Based on the BHC's agreement to ensure that the bank would comply with its own obligations, the FDIC, as receiver of the bank, moved for the bankruptcy court to require the BHC to cure the deficiencies in its capital maintenance obligations under section 365(o) or to convert its case to a Chapter 7 liquidation.[169] Unlike in IndyMac and Washington Mutual, the capital maintenance obligation claim in Colonial BancGroup was based on what the FDIC claimed to be an actual capital maintenance agreement, rather than on the generic source-of-strength obligation.

The FDIC lost the litigation over the motion. The bankruptcy court noted that the BHC's agreement did not trigger section 365(o) because it was not made with the "appropriate Federal banking agency," as required by section 365(o) because the term was defined as the *bank*'s primary federal regulator (the FDIC), whereas the agreement was made

163. Lee, *supra* note 4, at 771

164. *Failed Bank Information*, FDIC (Dec. 30, 2020) https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/colonial-al.html [https://perma.cc/B3TS-V595]

165. Bob Sims, *FDIC: Colonial Bank failure sixth largest in U.S. history*, AL.COM (Aug. 14, 2009, 10:10 PM) https://www.al.com/businessnews/2009/08/fdic_colonial_failure_sixth_la.html [https://perma.cc/2YRN-CWNR].

166. Petition, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Aug. 25, 2009) (Dkt. No. 1).

167. Motion of the Federal Deposit Insurance Corporation as Receiver for Colonial Bank, Montgomery, Alabama, for an Order (A) to Require Cure of Deficiencies under 11 U.S.C. § 365(o) or (B) Converting Debtor's Bankruptcy Case to a Liquidation under Chapter 7 of the Bankruptcy Code 2, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Nov. 5, 2009) (Dkt. No. 257).

168. *Id.* at 2.

169. *Id.* at 1.

with the Board, which was the BHC's regulator. Additionally, the court held that the language in the CALMA promising to "assist" the bank was too vague to make an actionable commitment for section 365(o) and that in any case the agreement was not curable because the bank was no longer operating.[170]

In addition to the section 365(o) motion, the FDIC also filed a $1 billion proof of claim, based primarily on capital maintenance obligations, but also regarding tax refund and REIT preferred securities.[171] The BHC filed an objection to the proof of claim.[172] The FDIC moved, without objection, to "withdraw the reference" to the bankruptcy court of the contested matter, thereby moving the case to the district court.[173] Certain aspects of the objection relating to ownership of tax refunds and REIT preferred securities were briefed and argued before the district court on cross-motions for summary judgment.[174] The capital maintenance element of the claim was never briefed or argued to the district court.

While the both an appeal of the section 365(o) ruling and the proof of claim litigation were *sub judice,* the FDIC settled with the BHC debtor.[175] The settlement covered both the proof of claim and section 365(o) motion, as well as the BHC's claim in the bank's receivership, a dispute about set-off rights regarding bank accounts the BHC maintained with the bank, and disputes about ownership of tax refunds and insurance proceeds.[176] As part of the settlement, the FDIC as receiver for the bank

170. *In re* Colonial BancGroup, Inc., 436 B.R. 713, 730-38 (Bankr. M.D. Ala. 2010).

171. Proof of claim No. 139, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Nov. 5, 2009).

172. Debtor's Objection to Proof of Claim of the Federal Deposit Insurance Corporation, as Receiver for Colonial Bank, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Mar. 4, 2010) (Dkt. No. 598); Debtor's Amended and Restated Objection to Proof of Claim of the Federal Deposit Insurance Corporation, as Receiver for Colonial Bank, *In re* The Colonial BancGroup, Inc., No. 2:10-bk-00409 (M.D. Ala. May 28, 2010) (Dkt. No. 12).

173. Motion of the Federal Deposit Insurance Corporation, as Receiver for Colonial Bank, to Withdraw the Reference of Several Pending Matters to Consolidate Proceedings Before the District Court, The Colonial BancGroup, Inc. v. Fed. Deposit Ins. Corp., as receiver for Colonial Bank (*In re* The Colonial BancGroup, Inc.), No. 2:10-mc-03502 (M.D. Ala. Apr. 1, 2010) (Dkt. No. 1); Opinion and Order 5, The Colonial BancGroup, Inc. v. Fed. Deposit Ins. Corp., as receiver for Colonial Bank (*In re* The Colonial BancGroup, Inc.), No. 2:10-cv-00409 (M.D. Ala. May 11, 2020) (Dkt. No. 1), (noting Colonial BancGroup's consent to the withdrawal of the reference). Bankruptcy cases are technically commenced in the district court, but every district court has a standing order of reference that sends all bankruptcy cases to the bankruptcy court. The order can be withdrawn upon motion in particular cases, however.

174. Debtor's Motion Pursuant to Bankruptcy Rule 9019 to Approve Proposed Settlement Agreement among FDIC-Receiver, Debtor, and Branch Banking and Trust Company 5-6, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Aug. 28, 2015) (Dkt. No. 2169).

175. *Id.*; Order Granting Debtor's Motion Pursuant to Bankruptcy Rule 9019 to Approve Proposed Settlement Agreement among FDIC-Receiver, Debtor, and Branch Banking and Trust Company, *In re* The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Oct. 1, 2015) (Dkt. No. 2177).

176. Debtor's Motion Pursuant to Bankruptcy Rule 9019 to Approve Proposed Settlement Agreement among FDIC-Receiver, Debtor, and Branch Banking and Trust Company 3-8,

dropped its claim in exchange for a release and ownership of approximately $263 million in tax refunds and insurance proceeds.[177]

What we see, then, in the three instances in post-2008 litigation where the FDIC invoked source-of-strength is that the doctrine resulted in little or no recovery. At the same time, none of the cases ever resulted in an opinion squarely on the doctrine. The closest case to address it, *Colonial BancGroup*, confined itself to questions about a specific capital maintenance agreement and did not touch on whether there is an enforceable source-of-strength obligation outside of contractual agreements as a result of Reg Y, much less whether it can be enforced by the FDIC as receiver (subrogated in right of the bank as beneficiary) or only by the Board as the BHC's regulator.

Although caution should be exercised in drawing negative inferences from the lack of judicial opinions or from the FDIC's litigation strategy, the impression these cases create is that the source-of-strength doctrine itself, as expressed in Reg Y, does not create liability for a BHC of a failed bank. Instead, the doctrine must be implemented through a properly drafted CALMA that details the capital maintenance obligation with some specificity and has the bank's primary regulator as a party to it. In other words, as the source-of-strength doctrine currently stands, it is nothing more than a matter of contract law, but federal regulators have repeatedly failed to draft the contracts adequately.[178]

As long as the source-of-strength doctrine exists primarily through contractual implementation, it will carry with it an unnecessary level of drafting and interpretation risk. Simply put, individually negotiated contracts are too fickle a tool for consistent implementation of public policy. It is unclear, however, if federal regulators have internalized the contract drafting lessons from these cases; a revision to Reg Y that would plainly create source-of-strength liability enforceable by the FDIC as receiver would avoid these problems.

IV. Samson, Shorn Again: Source-of-Strength After Dodd-Frank

A. *The Quasi-Codification of Source-of-Strength*

In the wake of the 2008 global financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Dodd-Frank section 616(d), entitled "Source of strength," provides that:

In re The Colonial BancGroup, Inc., No. 2:09-bk-32303 (Bankr. M.D. Ala. Aug. 28, 2015) (Dkt. No. 2169).

177. *Id.* at 10-13.

178. *See* FDIC v. Amtrust Fin. Corp. (*In re* Amtrust Fin. Corp.), 694 F.3d 741 (6th Cir. 2012) (capital maintenance obligations in agreement ambiguous).

The appropriate Federal banking agency for a bank holding company or savings and loan holding company shall require the bank holding company or savings and loan holding company to serve as a source of financial strength for any subsidiary of the bank holding company or savings and loan holding company that is a depository institution.[179]

Although it is tempting to think of section 616(d) as a codification of source-of-strength, it is not so much a codification of the doctrine, as a direction to federal banking regulators to enact regulations implementing the doctrine.[180] Nothing in Dodd-Frank Act section 616(d) itself actually creates a source-of-strength obligation; without a regulatory implementation, section 616(d) is nugatory.

Section 616(d) places some parameters on its direction to federal banking regulators by defining the term "source of financial strength":

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.[181]

The two key parameters in the definition are that (1) the BHC must have the "ability" to provide financial assistance to the bank and (2) provision of such assistance must be triggered by the bank's "financial distress." Nothing in the definition literally requires any actual financial assistance. Instead, it only requires the *ability* to provide financial assistance to the bank.

If Congress had wanted to state that the BHC was liable for any capital shortfall at the bank, it could have done so directly. That is not what Congress did with section 616(d). Perhaps it is simply because of poor drafting, but section 616(d) is also consistent with the original BHCA approach of requiring the Federal Reserve Board to consider the resources of the BHC when approving certain applications.

Irrespective of whether the word "ability" should be taken at face value, the definition is also tied to financial distress. Financial distress likely precedes a receivership, but is a bank in financial distress once it has failed and been taken into receivership? If not, does that mean that the source-of-strength obligation terminates with receivership, such that

179. Pub. L. No. 111-203, § 616(d), July 21, 2010, 124 Stat. 1616 (codified at 12 U.S.C. § 1831o-1(a)). Additionally, Dodd-Frank section 171 (the "Collins Amendment") requires federal regulators to establish minimum capital requirements for BHCs that are at least as strong as those for insured depository institutions. 12 U.S.C. § 5371(b). The effect of the Collins Amendment is to prevent BHCs from having capital structures that are weaker than their subsidiary banks. This is hardly a "source of strength" requirement, but it helps ensure that BHCs are not a "source of weakness" for their subsidiary banks.

180. *See* 12 U.S.C. § 1831o-1(e) (directing federal regulators to undertake an implementing rule by July 11, 2011).

181. 12 U.S.C. § 1831o-1(f).

the BHC has no liability to the FDIC, as receiver, for any shortfall in assets of the bank? It is far from clear that section 616(d) authorizes a regulation that would make the BHC liable in the event that the bank actually fails. But the scope of the delegation hardly matters given how the Federal Reserve Board has implemented section 616(d).

B. The Regulatory Implementation

The Dodd-Frank Act directed the Board to enact implementing regulations for section 616(d) within a year of the effective date of the Dodd-Frank Act.[182] The Board failed to do so. As of the date of this Article, fourteen years after Dodd-Frank, there is still no implementing regulation in place. Perhaps one will still emerge; in the spring of 2023 the Board placed promulgation of a rule on its long-term regulatory agenda.[183] At present, however, all that exists is the Reg Y provision, dating back to 1984, that "[a] bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner."[184]

As Reg Y currently stands, it does not appear to create any actual financial obligation for BHCs. Merely stating that the BHC "shall serve as a source of financial and managerial strength," is hardly the language of financial obligation. It does not use words like "shall guaranty" that would signal that the BHC was assuming a financial obligation. Nor does it state the extent of an obligation. At best, this language gives the Board the ability to exert supervisory pressure on operating BHCs to support their bank subsidiaries, but it is hard to imagine that it would create an enforceable obligation in the BHC's bankruptcy.

Even if Reg Y were interpreted as creating a financial obligation for the BHC, it is not clear who would have the power to enforce it. The beneficiary of the BHC's obligation would be the subsidiary bank, but it is unclear if enforcement authority would rest with the Board or if the bank would have a private right of action to enforce the obligation against its holding company. Presumably, the Board would have the ability to order compliance at the risk of the bank losing its charter, but that is not the same as having an enforceable monetary obligation.

Outside of receivership, the bank would, of course, never actually seek to enforce the obligation against the BHC, which controls it. The

182. *See* 12 U.S.C. § 1831o-1(e) (directing federal regulators to undertake an implementing rule by July 11, 2011).

183. *Source of Strength*, FED. DEPOSIT INS. CORP. (2023), https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202304&RIN=3064-AE61 [https://perma.cc/R6WU-2UDB].

184. 12 C.F.R. § 225.4(a)(1). An identical provision exists for savings and loan holding companies. *Id.* § 238.8(a)(1).

question of enforceability by the bank would matter, however, in the event of a receivership, because, as receiver, the FDIC would be subrogated to all of the bank's rights. If the bank had the ability to enforce the source-of-strength obligation, then so too could the FDIC as receiver, but if the bank lacked rights against the BHC, then the FDIC would not be able to use Reg Y to bring a claim against the BHC in its bankruptcy or exercise a setoff against the BHC in the bank's receivership.

Although the Board has not yet implemented section 616(d), it did adopt a regulation requiring large BHCs—those with at least $100 billion in assets—to develop and maintain capital plans.[185] A capital plan is required to include a detailed description of the BHC's process for assessing capital adequacy, including, *inter alia*:

A discussion of how the bank holding company will, under expected and stressful conditions, maintain capital commensurate with its risks, maintain capital above the regulatory capital ratios, and serve as a source of strength to its subsidiary depository institutions.[186]

The 2020 regulation was not adopted under section 616(d). It did, however, invoke the source-of-strength concept, just not in a manner that created an enforceable financial obligation. The inclusion of the source-of-strength in capital plans is merely a requirement regarding the contents of a capital plan, but there is nothing that commits a BHC to actually following a capital plan. Thus, for SVB Financial Group, the BHC for Silicon Valley Bank, the publicly available portion of its resolution plan merely stated that SVB Financial Group "serves as a source of strength for SVB, issuing capital and debt to the market and injecting the proceeds as capital investments into the Bank to support its growth opportunities."[187] The 2020 regulation resulted in the inclusion in capital plans of bland descriptive statements of BHCs' relation to their subsidiary banks, not any actual, enforceable financial support obligations.

C. Long-Term Debt and TLAC

Despite the Board's general failure to implement section 616(d) and the impotence of its source-of-strength requirement for the capital plans of large banks, the Board did take action regarding the BHCs for the very largest banks that has an effect similar to a real source-of-strength obligation. Dodd-Frank Act section 616(d) applies to all BHCs. There are a pair of additional requirements, however, for the BHCs for global sys-

185. *Id.* § 225.8(b).

186. *Id.* § 225.8(e)(2)(ii)(A).

187. FED. DEPOSIT INS. CORP., SILICON VALLEY BANK 2022 COVERED INSURED DEPOSITORY INSTITUTION RESOLUTION PLAN: PUBLIC SECTION (2022) https://www.fdic.gov/resources/resolutions/resolution-authority/resplans/plans/svb-idi-2212.pdf [https://perma.cc/9MXZ-276U].

temically important banks (G-SIBs).[188] The BHCs of G-SIBs are a very small subset of extremely large BHCs. At present, these additional requirements apply to only eight BHCs out of the approximately 3,500 top tier BHCs in the United States.[189]

Under a 2017 Board regulation,[190] G-SIB BHCs are required to maintain both (1) a minimum level of long-term debt (LTD) and (2) a minimum level of "total loss-absorbing capital" (TLAC). The LTD is required to be at least 6% of the G-SIB BHC's total risk-weighted assets and 4% of its total leverage exposure.[191] The LTD must be issued directly by the BHC, not by subsidiaries. The debt is required to be long term so as to avoid run or rollover risk.[192] The TLAC is required to be at least 18% of the G-SIB BHC's total risk-weighted assets and 7.5% of its total leverage exposure.[193] TLAC itself consists of tier 1 capital (mainly common equity) plus long term debt and 50% of debt of 1-2 years in maturity.[194] Additionally, G-SIB BHCs are restricted in their ability to pay dividends, bonus payments, or make other distributions if they do not have an adequate "TLAC buffer," made up solely of tier 1 common equity capital.[195] The LTD and TLAC requirements are over and above the general regulatory capital requirements for all BHCs.[196]

The LTD and TLAC requirements for G-SIB BHCs are designed to facilitate "single point of entry" (SPOE) resolutions. SPOE resolution is not explicitly required under U.S. law, but it is the resolution strategy that all eight U.S. G-SIBs have adopted in their living wills,[197] and is the strategy favored by the Board.

In a SPOE resolution, only the top-level holding company would file for bankruptcy or go through a resolution, while all of the subsidiaries would continue to operate as normal. The LTD of the top-level holding

188. G-SIB BHCs are defined as those BHCs whose "method 1" score, defined in 12 C.F.R. § 217.404, equals or exceeds 130. 12 C.F.R. § 217.402.

189. *Annual Report – 2021*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (2021), https://www.federalreserve.gov/publications/2021-ar-supervision-and-regulation.htm [https://perma.cc/5CYC-L77P] (identifying 3,523 top tier BHCs as of the end of 2021 plus another 154 top tier S&L holding companies).

190. 82 Fed. Reg. 8266 (Jan. 27, 2017).

191. 12 C.F.R. § 252.62(a).

192. *Id.* § 252.61 (defining "eligible debt security").

193. *Id.* § 252.63(a). Similar requirements exist for intermediate holding companies—the US ring-fenced subsidiaries of large foreign BHCs. *Id.* §§ 252.160, 252.163.

194. *Id.* § 252.63(b).

195. *Id.* § 252.63(c).

196. *Id.* § 217.11(a).

197. Anna T. Pinedo et al., *Shifting Sands: New Prudential Standards for Larger Regional Banks Under Consolidation by US OCC*, MAYER BROWN (2022) https://www.mayerbrown.com/en/perspectives-events/publications/2022/04/shifting-sands-new-prudential-standards-for-larger-regional-banks-under-consideration-by-us-occ [https://perma.cc/RF9U-FSR2]. In contrast, a multiple point of entry (MPOE) resolution would involve multiple legal proceedings each of which would address a set of the different affiliated entities.

company would be "bailed in" in an SPOE, meaning that the LTD would be converted into common equity of a recapitalized holding company, which could then recapitalize any troubled operating subsidiaries, which could continue operating as going concerns.[198] The bail-in of the BHC's LTD to ensure adequate bank capitalization is equivalent to a guaranty of the bank's obligations by the BHC that has priority over the LTD. Thus, the LTD and TLAC requirements are effectively a source-of-strength requirement…but only for G-SIB BHCs, meaning for all of eight BHCs of approximately 3,500 top tier BHCs in the U.S.

Although a SPOE bail-in resolution strategy is plainly the thinking behind the LTD and TLAC requirements, two key elements are missing from the regulations to make sure that a resolution would in fact operate as a SPOE bail-in. First, there is no express requirement in American law for the LTD of a G-SIB BHC to be convertible.[199] This is in contrast to the express convertibility requirement for the LTD of intermediate holding companies—that is the required U.S. subsidiary holding companies of large, top tier foreign BHCs.[200] Instead, the convertibility assumption gets played out through the soft regulation of the supervisory process.

Second, there is no requirement beyond the general source-of-strength regulation that the G-SIB BHC ever actually prop up distressed subsidiaries. The Board explained that:

> The requirements in the final rule are written under the assumptions that a covered BHC would recapitalize its subsidiaries in the event of distress so that the subsidiaries could remain operational outside of a bankruptcy or resolution proceedings and that losses the covered BHC sustained by such recapitalization could be imposed on holders of TLAC through a bankruptcy or resolution proceeding.[201]

In theory, a G-SIB BHC could always decide to walk away from a failed bank subsidiary. In practice, however, this is unthinkable. If the G-SIB BHC has a single bank subsidiary, that subsidiary is likely the central engine of the BHC's business, such that its failure would doom the whole BHC. To the extent that the G-SIB has sufficient resources because of TLAC and convertible LTD, it would be incentivized to recapitalize its struggling depository subsidiary. And if the BHC had multiple bank subsidiaries, they would all be tied together with the FDIA cross-guaranty,[202] so even if the BHC itself could walk away, its other bank subsidiaries

198. 80 Fed. Reg. 74934; 82 Fed. Reg. 8301 (Jan. 27, 2017); 85 Fed. Reg. 17003, 17003 n.3 (Mar. 26, 2020).

199. 82 Fed. Reg. 8284 (Jan. 27, 2017).

200. *See* 12 C.F.R. § 252.163.

201. 82 Fed. Reg. 8284 (Jan. 27, 2017).

202. 12 U.S.C. § 1815(e)(1)(A).

could not. The effect, then of the LTD and TLAC requirements is that the BHCs of G-SIBs will back the G-SIBs obligations, as long as it has the ability to recapitalize the troubled G-SIB.

This is a different position than that of non-G-SIB BHCs— the great mass of BHCs—which, because of the lack of required LTD and TLAC might not be in a position to support a troubled subsidiary bank. The BHC of a troubled non-G-SIB bank might reasonably decide that it is in the best interests of its shareholders and creditors to cut its losses and preserve whatever value exists in the corporate family outside of the bank.

In summary, then, all BHCs are subject to the general Reg Y requirement that they be a "source of financial and managerial strength" for their subsidiary banks. On top of that, BHCs with over $100 billion in assets are required to have capital plans, which must include a source-of-strength provision. Beyond that, the BHCs of G-SIBs are additionally required to have LTD and TLAC in their capital structure, to facilitate the use of SPOE to recapitalize troubled subsidiaries. The general Reg Y provision, however, does not represent an enforceable obligation for the BHC, nor does the capital plan. The LTD and TLAC requirements do achieve something close to an actual source-of-strength requirement, but they are only for the BHCs of G-SIBs and are done under a separate authority than source-of-strength.

D. Industrial Loan Company Holding Companies

Although the Board has failed to directly implement section 616(d), the FDIC has taken steps to actualize the source-of-strength doctrine for the holding companies of industrial loan companies (ILCs). ILCs are state-chartered entities required by state law to have deposit insurance, but which are not "banks" for the purposes of the BHCA, provided that they either: (1) do not accept demand deposits, (2) have total assets of under $100 million, or (3) have not been acquired by another company after 1987.[203] As ILCs are not "banks" for BHCA purposes, their holding companies—often industrial or retail companies like BMW or Target—are not subject to regulation by the Board as BHCs. Accordingly, section 616(d) does not apply to ILC holding companies. ILCs themselves, however, are regulated by the FDIC as insured, non-member state banks.

The FDIC has historically required that an ILC's parent company enter into a CALMA as a precondition of deposit insurance, and in 2021, the FDIC issued a rule that formalized this requirement.[204] The FDIC rule prohibits any ILC from becoming the subsidiary of another company

203. *Id.* § 1841(c)(1)(F).

204. 86 Fed. Reg. 10703 (Feb. 23, 2021) (codified at 12 C.F.R. pt. 354).

absent a written agreement with both the FDIC and the ILC that includes certain mandatory provisions.[205] Among these required provisions is that the parent company agrees to maintain capital and liquidity at the ILC subsidiary at a level the FDIC deems appropriate.[206]

The FDIC's ILC holding company rule grandfathers existing ILCs from the rule,[207] but at least for new or restructured ILCs, the rule guarantees that there will be a CALMA in place that would be enforceable by the FDIC in the event of the parent company's bankruptcy. Moreover, having the ILC itself be a party to the CALMA means that any recovery would be by the FDIC as receiver, subrogated to the failed ILC, rather than as regulator, so the recovery could be used to offset losses to the deposit insurance fund, rather than just going to Treasury.

Yet CALMAs required by the FDIC's rulemaking could still fall afoul of the Bankruptcy Code if they are not sufficiently definite. For example, if the CALMA merely requires capital to be maintained to the FDIC's satisfaction, but the FDIC has not specified a particular dollar amount at the time of the parent company's bankruptcy, the CALMA might not qualify for preferred treatment under Bankruptcy Code sections 365(o) and 507(a)(9), and it might not be the basis for an allowable bankruptcy claim at all. The FDIC's approach of requiring CALMAs risks the possibility of a *Colonial BancGroup* type problem, where the FDIC's claim would fail because of contract drafting issues. There is no reason for the FDIC's ability to recover from an ILC holding company under the source-of-strength doctrine to depend on the vagaries of contract drafting.

E. Silicon Valley Bank Financial Group's Bankruptcy

The current limited bite of the source-of-strength doctrine can be seen most plainly in the fallout from the failure of Silicon Valley Bank. Silicon Valley Bank was placed into an FDIC receivership on March 10, 2023.[208] The FDIC is normally required to pursue the least-cost resolution of a failed bank, but this requirement is subject to a systemic risk exception,[209] which was invoked on March 12, 2023,[210] permitting the FDIC to

205. 12 C.F.R. § 354.3.

206. *Id.* § 354.4(a)(7).

207. 86 Fed. Reg. 10703, 10714 (Feb. 23, 2021).

208. Order Taking Possession of Property and Business, *In re* Silicon Valley Bank, Before the Department of Financial Protection and Innovation of the State of California (Mar. 10, 2023), https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/DFPI-Orders-Silicon-Valley-Bank-03102023.pdf [https://perma.cc/BU9V-G6TX]; Appointment and Tender of Appointment as Receiver, *In re* Silicon Valley Bank, Before the Department of Financial Protection and Innovation of the State of California (Mar. 10, 2023), https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/SVB-tender-of-appointment.pdf [https://perma.cc/Z58J-78QN].

209. 12 U.S.C. § 1823(c)(4)(G).

guaranty payments above the regular FDIC insurance coverage limit of $250,000 per depositor per insured bank, per ownership category.

In a press release, the Treasury, the Board, and the FDIC announced that the FDIC would complete the resolution "in a manner that fully protects all depositors. Depositors will have access to all of their money starting Monday, March 13." The next day, the FDIC confirmed this in another press release, stating that it had transferred all deposits of Silicon Valley Bank to a bridge bank and that "All depositors of the institution will be made whole."[211] In neither case were any exceptions announced.

At that time of the bank's failure, the bank's holding company, SVB Financial Group, had approximately $2.1 billion on deposit with the bank.[212] The holding company was able to access the deposits on March 15 and part of March 16, transferring approximately $150 million of funds.[213] The FDIC prevented funds transfers starting on the afternoon of March 16,[214] and subsequently told SVB Financial Group that SVB Financial Group would have to file a proof of claim in the receivership to recover any of the remaining $1.93 billion.[215] On March 17, SVB Financial Group filed for Chapter 11 bankruptcy[216] and sought to compel the FDIC to turn over the deposit as property of the bankruptcy estate.[217]

The FDIC never filed a proof of claim in SVB Financial Group's bankruptcy, in either its corporate capacity or its capacity as receiver for the bank. Instead, it allowed the governmental bar date to pass. The FDIC likely opted against filing a claim so as to avoid consenting to the jurisdiction of the bankruptcy court in the turnover action. The FDIC successfully moved to "withdraw the reference" to the bankruptcy court

210. Press Release, Federal Deposit Insurance Corporation, Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC (Mar. 12, 2023) https://www.fdic.gov/news/press-releases/2023/pr23017.html [https://perma .cc/PAG3-6A88].

211. Press Release, Federal Deposit Insurance Corporation, FDIC Acts to Protect All Depositors of the former Silicon Valley Bank, Santa Clara, California (Mar. 13, 2023) https://www.fdic.gov/news/press-releases/2023/pr23019.html [https://perma.cc/6YHG-B2YG].

212. Statement of SVB Financial Group with Respect to Letter from the Federal Deposit Insurance Corporation, Acting in in Its Corporate Capacity 2, *In re* SVB Financial Group, No. 23-10367-mg, (Bankr. S.D.N.Y. Nov. 6, 2023) (Dkt. No. 655), at https://fingfx.thomsonreuters.com/gfx/legaldocs/egpbmgngovq/Doc%20655%20Statement%20re%20FDIC-C%20Denial%20Letter.pdf [https://perma.cc/R3KC-HE49].

213. *Id.* at 3-4.

214. *Id.*

215. *Id.* at 4 (referencing 12 U.S.C. § 1822(d)).

216. SVB Financial Group, Voluntary Petition for Non-Individuals Filing for Bankruptcy, No. 23-10367-mg (Bankr. S.D.N.Y. Mar. 17, 2023) (Dkt. No. 1).

217. Complaint, SVB Financial Group v. FDIC (*In re* SVB Financial Group), Adv. Proc. No. 23-01137 (Bankr. S.D.N.Y. July 9, 2023) (Dkt. No. 1) (invoking 11 U.S.C. §§ 362(a) and 542).

for the turnover action, meaning that the case would be heard by the district court, generally seen as a less debtor-friendly venue.[218]

As of the writing of this Article, the turnover litigation is still pending, but the FDIC has not so much as mentioned "source-of-strength" in any of its pleadings to date, and there does not appear to have been a CALMA in place with the BHC. This would limit the FDIC to invoking only the general doctrine, rather than a contractual application. Overall, the history of the doctrine in the fallout from the 2008 financial crisis suggests that the FDIC is unlikely to expect the doctrine to do much work, if it even invokes it at all.

IV. Actualizing Source-of-Strength

As U.S. law currently stands, the BHCs of G-SIBs are expected to back the obligations of the G-SIBs and recapitalize them as necessary, first through their TLAC and then through their LTD. But there is no express provision making the BHC of any bank, G-SIB or not, a guarantor of the bank's obligations or at least of its liabilities to the FDIC in the event of a receivership. This Article renews the calls from the 1990s for changing this. If source-of-strength is to be anything other than a deceptively aspirational doctrine that lulls Congress, regulators, and the public into thinking that it makes BHCs legally bound sources of capital support for their subsidiary banks, then it needs to be transformed through a regulatory implementation that formally deems BHCs to be guarantors of bank obligations. Given that the FDIC, OCC, and Board have announced that they plan on developing a joint source-of-strength rule implementing section 616(d),[219] an opportunity may be at hand. This Part considers why a source-of-strength rulemaking should make all BHCs guarantors for all of their bank subsidiaries' obligations.

A. The Positive and Negative Aspects of BHCs

The primary use of BHCs is to enable affiliations between banks and nonbanks. Such affiliations have both negative and positive aspects.

Bank affiliations with nonbanks are well-understood to be a potential source of considerable risk within the banking system. Consider a pair of scenarios motivating bank affiliation with nonbanks. In one scenario, the motivation for the affiliation is for the bank to provide below-market

218. Motion of the Federal Deposit Insurance Corporation, as Receiver for Silicon Valley Bank, for an Order Withdrawing the Reference of Adversary Proceeding Pursuant to 28 U.S.C. § 157 and Federal Rule of Bankruptcy Procedure 5011, SVB Financial Group v. FDIC (*In re* SVB Financial Group), Adv. Proc. No. 23-01137 (Bankr. S.D.N.Y. Aug.11, 2023) (Dkt. No. 30); Opinion and Order, SVB Financial Group v. FDIC (*In re* SVB Financial Group), Adv. Proc. No. 23-01137 (S.D.N.Y. Dec. 13, 2023) (granting motion to withdraw the reference).

219. *Source of Strength*, *supra* note 183.

financing for its nonbank affiliates.[220] In such a situation, the bank risks becoming decapitalized by making below-market loans, in which it is not adequately compensated for the risk it assumes. At the same time, the subsidy of federal deposit insurance leaks out of the banking system to the nonbank affiliates, giving them an undeserved competitive advantage.

A second scenario motivating affiliation is for a bank to parlay its relationship of trust with customers by recommending its affiliates' services to its customers. This sort of cross-selling can be an effective method of customer acquisition for the nonbank affiliates.[221] Yet in doing so, the bank risks losing its own customer base if its customers are unhappy with its nonbank affiliates, as the bank might be held responsible for the bad recommendation.

In both scenarios, the bank has tied its fortunes to its nonbank affiliates, the business conduct of which is largely outside of the purview and expertise of the Board. The Board is concerned primarily with the financial condition of nonbank affiliates and the internal management controls over the nonbank affiliates[222] which has often taken a lax stance on the terms of affiliate transactions.[223] For example, the Board does not even consider "reputational risk" to be a "core risk."[224]

Even if neither of these scenarios were the motivation for affiliation, an affiliation with a nonbank makes the bank a tempting source of capital if the nonbank affiliates run into trouble and need to be recapitalized. Indeed, even if there is no misuse of the affiliation with the bank, the mere fact of the affiliation exposes the bank to reputational risk: problems with the business of an affiliate could trigger a run on the bank, either out of lack of depositor or counterparty information about the internal relations

220. Although bank transactions with affiliates are subject to regulatory limitations, 12 U.S.C. §§ 371c-371c-1, 12 C.F.R. Pt. 223 (Reg W), these are on a standard of "terms and conditions that are consistent with safe and sound banking practices," which is not necessarily synonymous with market terms.

221. The depository subsidiaries of financial holding companies are restricted in their ability to cross-market the services and products of nonbank affiliates that are not engaged in financial services. 12 U.S.C. § 1843(n)(6); 12 C.F.R. § 225.176. In practice this means that the depository subsidiaries of financial holding companies cannot cross-market for their affiliates held under the financial holding company's merchant-banking authority. Thus, a bank could not cross-market for the tequila sold by an affiliate distillery in which the financial holding company had more than a 5% equity stake. No such cross-marketing restriction exists regarding the affiliates engaged in financial services. Thus, a bank can freely market the products of its broker-dealer or insurance affiliates.

222. *See generally* BD. OF GOVERNORS OF THE FED. RSRV. SYS., BANK HOLDING COMPANY SUPERVISION MANUAL (Nov. 2021) https://www.federalreserve.gov/publications/files/bhc.pdf [https://perma.cc/S56K-HN4J].

223. Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 1683, 1690 (2011) (noting the Board's extensive use of exemptive authority regarding affiliate transactions).

224. BD. OF GOVERNORS OF THE FED. RSRV. SYS., BANK HOLDING COMPANY SUPERVISION MANUAL SUPPLEMENT 50—(JULY 2016), (Feb. 2023) https://www.federalreserve.gov/publications/files/bhc.pdf [https://perma.cc/2PE7-BM9Q].

within the conglomerate or because of a concern that the bank would be used to support the nonbank and become decapitalized.

Yet it is not clear that all affiliations with nonbanks should be viewed negatively. If a well-established nonbank were to affiliate with a bank, the bank could piggyback on the reputation of the nonbank to gain clientele. An example of this is Goldman Sachs's acquisition in 2016 of a GE Capital Bank's online deposit platform and approximately $16 billion of deposits.[225] Although Goldman Sachs has been a BHC since 2008,[226] its reputation derives primarily from its origins as a broker-dealer. The acquisition was done by Goldman Sachs Bank USA, and became the base for Marcus by Goldman Sachs, an on-line consumer bank. Marcus (and Goldman Sachs Bank USA) were able to trade on the Goldman Sachs name, enabling them to grow a client base more rapidly than they would have been able to do otherwise, achieving over $50 billion of deposits.[227] (Of course, given the affiliation, the reputational fortunes of Marcus are still tied to those of Goldman Sachs; if the broker-dealer were to fail, there would surely be customer flight from Marcus.)

Another positive scenario for affiliation is for the nonbank affiliate to be a captive service provider for the bank. The affiliate might provide the bank with services at below-market rates or services that cannot be obtained elsewhere, but that the bank cannot bring in-house because of its own activity restrictions.[228]

Likewise, a BHC can facilitate the acquisition of additional banks in ways that reduce operational risk. If a bank wished to acquire another bank directly, it would have to merge the bank into itself, necessitating an immediate and seamless integration of operations.[229] That is no small challenge given IT systems that might not speak to each other and for which adequate APIs might not exist. Having a BHC enables the acquisition to be made by the BHC, which can hold the two banks as separate banking entities until it is confident that they can be operationally integrated, and only then merge them.[230]

225. Press Release, Goldman Sachs, Goldman Sachs Bank USA to Acquire the Online Deposit Platform and Assume the Deposits of GE Capital Bank (Aug. 13, 2015), https://www.goldmansachs.com/media-relations/press-releases/current/announcement-13-aug-2015.html [https://perma.cc/WR47-G9AA].

226. Press Release, Goldman Sachs, Goldman Sachs Announces It Will Become a Bank Holding Company (2019), https://www.goldmansachs.com/our-firm/history/moments/2008-bank-holding-company.html [https://perma.cc/X9RY-WD7U].

227. Press Release, Marcus by Goldman Sachs Leverages Technology and Legacy of Financial Expertise in Dynamic Consumer Finance Platform (2019), https://www.goldmansachs.com/our-firm/history/moments/2016-marcus.html [https://perma.cc/SR29-FEFB].

228. *See* 12 C.F.R. § 225.22(b)(2) (authorizing BHCs to engage in or own companies that engage in provision of services solely for the internal operations of the BHC or its subsidiaries, including the bank subsidiary).

229. *Benefitting from the Flexibility of a Bank Holding Structure*, *supra* note 13.

230. *Id.*

Additionally, BHCs can be used in ways that have nothing to do with affiliation with nonbanks, such as the use of shell BHCs as acquisition vehicles. If individuals want to create a new bank, they will have to capitalize it and may want to borrow some of the funds to do so. If they do not use a BHC, they will need to borrow the funds themselves, and be personally liable on the debt.[231] In contrast, if they form a BHC, it can borrow the money that will be used to capitalize the bank. This scenario has nothing to do with affiliation; the BHC is merely an acquisition shell that poses no inherent risk to the bank.

This is not meant to be an exhaustive cataloging of the risks and benefits of BHCs. Instead, it is to underscore that there are both negative and positive aspects to bank affiliation with nonbanks, an affiliation that requires the existence of BHCs. Regulators, however, are poorly positioned to identify whether an affiliation through a BHC is a negative or positive thing, and that may change over time. Regulators simply lack adequate expertise in evaluating the businesses of non-bank affiliates and may also fail to understand the nature of their relationship with the bank. An actual source-of-strength requirement that would make the BHC the guarantor of the obligations of its bank subsidiaries would provide a market mechanism for sorting between these good and bad uses of BHCs, providing a market backstop for regulation.

B. BHC Guaranties as a Market Mechanism for Taxing Negative Nonbank Affiliations and Backstopping Regulators

As long as there is internal limited liability, the investors in the BHC—both its bondholders and its shareholders—are exposed to the losses incurred by the bank only to the extent of the BHC's equity investment in the bank.[232] Eliminating internal limited liability and making the BHC liable for the bank's obligations would remove the moral hazard of limited liability within the corporate group and mean that that the investors in the BHC would be fully exposed to the losses incurred by the bank, at least up to the extent of their investment in the BHC (external limited liability would still be preserved).

If the exposure of BHC investors to the bank were itself increased, then the BHC investors would, presumably, charge more for their capital the riskier the bank is. This means that if the BHC exists for the purpose of enabling nonbank affiliates to ride the bank's coattails or if the nonbank affiliates are themselves posing reputational risk to the bank, then the BHC will face a higher cost of capital. But if the BHC is only per-

231. Keeton, *supra* note 7, at 55.

232. The failure of the bank might affect the value of the BHC's other subsidiaries, however.

forming neutral or positive functions, then it will not be tagged with a higher cost of capital from its investors. In short, if the BHC and resulting affiliations with nonbanks produce positive synergies, there will be no adverse market effect, but if the affiliations impose greater risk on the bank, then market discipline will kick in and the BHC will face higher costs of capital because of the greater risk posed to its investors.

An actual source-of-strength requirement in the form of a deemed BHC guaranty thus taxes negative affiliations with nonbanks, which is exactly what we should want. It creates a market mechanism for sorting between positive and negative bank affiliations with nonbanks, something that regulators cannot readily do, both because they might not fully understand the relationship among the affiliates and because they might want to curtail what is, in the short-term, a profitable affiliation, even if it poses risk that could materialize in the long-term.

Such a market mechanism is not a replacement for prudential regulation and supervision, but a backstop for it. Perhaps the key lesson from the last twenty years of banking regulation is that regulators are deeply fallible. This does not by any means imply that regulation should be jettisoned—a regulatory vacuum is even worse than fallible regulators—but that regulators should be backstopped by market checks whenever possible.

C. SPOE-for-All

An actual source-of-strength requirement in the form of a deemed BHC guaranty would also effectively be "SPOE-for-all," insofar as it would expose the equity holders and the bondholders of the BHC to the losses of the bank, even if multiple resolution proceedings could still be used for different members of the BHC's corporate family. The key motivation of bail-in-able debt in the SPOE resolution strategy is to facilitate a single resolution proceeding at the holding company level so as to avoid disruption to subsidiary operations. Nevertheless, SPOE has the added benefit of creating market discipline by structurally subordinating BHC-level bondholders to bank creditors.[233] The bank creditors (including the insured deposits and hence the FDIC) would have first dibs on all the assets at the bank level, but still be able to make a claim on the other assets of the BHC that would rank equally with the claims of the bondholders.

It is this market discipline benefit, rather than the single locus for resolution, that is captured by an SPOE-for-all approach of mandating BHC guaranties of the bank. Such structural subordination would moti-

233. *But see* Stephen J. Lubben & Arthur E. Wilmarth, Jr., *Too Big and Unable to Fail* 69 FLA. L. REV. 1205 (2017) (arguing that the risk of SPOE and TLAC rules falls mainly on poorly informed investors in mutual funds and pension funds, thereby limiting the market discipline effect).

vate BHC bondholders to engage in better monitoring and risk-pricing of the BHC's debt. It would also ensure that there is a greater pool of assets available from which the FDIC's deposit insurance fund can recover in the event of a bank failure. And in some cases, it would generate valuable information for regulators. For larger BHCs, there would be sufficient credit default swap spread information on the BHC's bonds that would provide a visible indicator to everyone—including regulators—of the market's evaluation of the bank's health.

Thus, deeming the BHC a guarantor of the bank's obligations will not only improve market discipline, but will also improve information for regulators, giving them data against which they can cross-check their supervisory efforts. For example, if CDS spreads on a BHC's bonds start to widen, it should be an early warning signal to the Board the need to investigate the condition and management of the BHC and for the bank's regulators to review the condition of the bank.

Presumably, this Article's call for making BHCs guarantors of their subsidiary banks will be met with pushback based on the supposedly sacrosanct nature of limited liability—that much has happened to prior proposals in the 1990s.[234] As this Article has shown, although limited liability has numerous social benefits, it need not be treated as such a sacred cow. It is a relatively recent doctrine, it is one that sizeable companies in the U.S. and abroad[235] have managed without, and it is already curtailed in certain instances by federal law. Additionally, the social benefits of limited liability are produced primarily by external limited liability, rather than by internal limited liability within the corporate conglomerate.[236] A curtailment of limited liability for BHCs is not an attack on limited liability writ large, but a well-justified, targeted restriction undertaken in a context where the moral hazard from limited liability is of particular policy concern.

Conclusion

Throughout its history, the source-of-strength doctrine has been a toothless tool of bank regulation. It has been hortatory and aspirational but has not actually created any enforceable legal obligation absent specific contractual implementations, which have repeatedly been botched by regulators.

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234. *See, e.g.*, Eric J. Gouvin, *Shareholder Enforced Market Discipline: How Much Is Too Much?*, 16 ANN. REV. BANKING L. 311 (1997) (arguing for generally respecting limited liability and for making the BHC liable only to the extent that that the bank failed to discharge duties to nonshareholder constituents).

235. Mariana Pargendler, *How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil*, 58 COLUM. J. TRANSNAT'L L. 2 (2019) (describing decline of limited liability in Brazil).

236. Hansmann & Squire, *supra* note 11, at 11-12.

It is time to change that. The Federal Reserve Board should finally implement section 616(d) of the Dodd-Frank Act to require all banks to have BHCs and require BHCs to guaranty the obligations of their bank subsidiaries. Doing so would impose the same sort of market discipline on all BHCs as TLAC and LTD requirements do for the BHCs of G-SIBs, encouraging better management of bank subsidiaries. BHC guaranties of the bank's obligations would also provide an expanded source of recovery for the FDIC deposit insurance fund in the event of the bank's failure. And making BHC-level debt more sensitive to the risks of the bank would create an important market check to backstop the supervisory efforts of regulators.

For too long the source-of-strength doctrine has served as Samson's toupée. It is time to let the doctrine grow out its hair and become a real source-of-strength for the banking system.