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# **Sweeping Away the Cobwebs: North Carolina's Banking Law Modernization Act**

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## I. INTRODUCTION

For many years, former North Carolina Commissioner of Banks Joseph A. Smith, Jr., worked assiduously to modernize certain provisions of Chapter 53 of the North Carolina General Statutes (Old Law),<sup>1</sup> which governed North Carolina commercial banking corporations (referred to throughout this article as “banks”). Modernizing North Carolina banking law was a long-time goal of the North Carolina Office of the Commissioner of Banks (OCOB). Beginning at least as early as 2003, Commissioner Smith convened meetings of banking lawyers and the OCOB staff to discuss ambitious modernization plans. It was a galling irony that banks chartered by a state at the forefront of the banking industry were governed by an obsolete statutory scheme enacted before the Great Depression. Although many revisions were made over the years, the Old Law, together with certain administrative rules and some interpretive positions that accreted over many years, was full of figurative cobwebs

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1. N.C. GEN. STAT. § 53 (repealed 2012). The statute was repealed effective Oct. 1, 2012, except for N.C. GEN. STAT. § 53-92, which was repealed effective Apr. 1, 2013.

and dust balls that created unnecessary confusion and archaic limitations. In contrast, North Carolina savings banks were, and still are, governed by a relatively modern statutory scheme enacted in 1991.<sup>2</sup>

From the day Commissioner Smith assumed office, the OCOB was beset by pressing problems involving mortgage lending, pay-day lending, and other consumer matters. Later, the effects of the financial crisis on North Carolina financial institutions monopolized the OCOB's attention. So, despite all of the hard work and dedication of Commissioner Smith, the OCOB staff, and many banking lawyers, no comprehensive revision emerged until Commissioner Smith asked the North Carolina General Assembly to create, in June of 2011, a "Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws" (Study Commission).<sup>3</sup> Commissioner Smith enlisted Paul H. Stock, upon his retirement from the North Carolina Bankers Association, to join the OCOB staff and lead it in preparing drafts for the Study Commission's review. Banking lawyers in private practice commented on and helped with these drafts, but did not participate as fully as Commissioner Smith envisioned in the earlier efforts.

Commissioner Smith was drafted in February of 2012 to head the Office of Mortgage Settlement Oversight, created by the foreclosure settlement among forty-nine states and the five largest mortgage loan servicers in the United States. The OCOB, now led by Acting Commissioner Raymond E. Grace, continued to work with the Study Commission. The Study Commission's efforts resulted in the passage of Senate Bill 816, "An Act to Rewrite the Banking Laws of North Carolina, as Recommended by the Joint Legislative Study Commission on the Modernization of North Carolina Banking Law" (together with Chapter 53C of the North Carolina General Statutes it enacts, BLMA).<sup>4</sup> Most provisions of the BLMA became effective October 1, 2012.<sup>5</sup>

Chapter 53 of the North Carolina General Statutes was not repealed in its entirety, and now is re-titled "Regulation of Financial

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2. N.C. GEN. STAT. § 54C (2011). In early discussions, Commissioner Smith and those working with him considered a unitary charter for banks and savings banks. North Carolina-chartered savings banks continue to be governed by Chapter 54C. North Carolina law also provides for savings and loan association charters in Chapter 54B of the North Carolina General Statutes, enacted in 1981. As of this writing, only Mount Gilead Savings and Loan Association in Montgomery County, North Carolina, is governed by Chapter 54B.

3. 2011 N.C. Sess. Laws 353.

4. 2012 N.C. Sess. Laws 56 (codified at N.C. GEN. STAT. §§ 53, 53C (Supp. 2012)).

5. *Id.*

Services.” Many of its articles remain in effect. Some of those articles, such as those concerning money transmitters and check cashers, do not pertain directly to bank regulation. Remaining articles directly relevant for banking organizations include:

- Article 14 on bank trust departments and Article 24 on independent trust companies;
- Articles 17 and 17B, which together implement North Carolina’s choices about interstate mergers and branching under the Riegler-Neal Interstate Banking and Branching Efficiency Act;
- Article 18 on bank holding companies;<sup>6</sup>
- Article 18A on international banking; and
- Article 19B, on mortgage lending, and Article 21 on reverse mortgages.

As this article is being written in early 2013, the OCOB is working on a proposed clarifications and corrections bill (the “Clarifications Bill”) to clean up minor errors and omissions that were inevitable in a project of this magnitude. The North Carolina Rules Review Commission has also approved some updates to the Commissioner’s bank regulations.<sup>7</sup> Though these rules are “permanent,” the revisions in reality were temporary, and the OCOB is working on a proposal for comprehensive regulatory revision.

This article describes the major provisions of the BLMA. For North Carolina banks, the BLMA generally seeks to reduce burdens and prohibitions not warranted by prudential bank regulation, without imposing new burdens or prohibitions of any great consequence. The BLMA’s purpose was, after all, to modernize the banking law. This article will discuss various aspects of the Old Law, but will not review every cobweb that the BLMA swept away, nor compare every BLMA provision discussed with its counterpart in the Old Law.

Most provisions of the BLMA should be read in conjunction

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6. Redundancy between Article 18 of Chapter 53 and Article 10 of the BLMA may be addressed in the “Clarifications Bill” discussed below. See *infra* Part II-IV for discussion of some ambiguities created by that redundancy.

7. 04 N.C. ADMIN. CODE 03C (2012).

with applicable federal banking laws and regulations, which are beyond the scope of this article. For example the section of this article on mergers and other combinations<sup>8</sup> will not discuss the requirements of the federal Bank Merger Act.<sup>9</sup>

## II. BANK GOVERNANCE; BOARD AND OFFICER RESPONSIBILITY

Article 4 of the BLMA<sup>10</sup> addresses bank boards of directors and certain other bank governance matters.

### A. *North Carolina Business Corporation Act*

The BLMA explicitly provides that the North Carolina Business Corporation Act applies to banks except where Chapter 53C provides differently or where the Commissioner determines that any provision of that act is inconsistent with the business of banking or safety and soundness.<sup>11</sup>

### B. *Board Governance, Composition, and Director Requirements*

A bank's corporate powers are exercised "by or under the authority of" the bank's board of directors.<sup>12</sup> Bank directors have the same duties, authority, and liabilities as directors of business corporations organized under the North Carolina Business Corporation Act.<sup>13</sup> "As part of its examinations of a bank, the OCOB may assess the competence, composition, structure, and conduct of such bank's board of directors," based on various factors including the "asset size" of a bank and the "range and complexity" of its activities.<sup>14</sup> The BLMA also provides statutory authority for the appointment of advisory board

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8. *See infra* Part VI.

9. 12 U.S.C. § 1828(c)(1) (2006) (requiring FDIC approval of mergers of insured institutions and other transactions involving assumption of deposit liabilities).

10. N.C. GEN. STAT. §§ 53C-4-1 to -12 (Supp. 2012).

11. § 53C-4-1(b). The Old Law contained a similar provision that did not include the explicit provision that the Commissioner determined when a provision of the North Carolina Business Corporation Act was inconsistent with the business of banking. N.C. GEN. STAT. § 53-135 (repealed 2012).

12. N.C. GEN. STAT. § 53C-4-2(a) (Supp. 2012).

13. § 53C-4-2(d).

14. § 53C-4-10.

members, who shall not be subject to liability as directors unless they undertake to act as a director or director authority is actually delegated.<sup>15</sup>

Recognizing the increasingly interconnected global economy and North Carolina's position as a leader in the financial services sector, the BLMA relaxes rules on the required composition of a bank's board of directors.<sup>16</sup> The BLMA does not require that North Carolina residents comprise any minimum percentage of a bank's board of directors, and only three-fourths of the directors of a bank are required to be citizens of the United States.<sup>17</sup> The board of directors ordinarily must consist of at least five individuals,<sup>18</sup> as under the Old Law,<sup>19</sup> however, the BLMA empowers the Commissioner to approve boards with fewer than five members.<sup>20</sup>

Bank directors "must satisfy eligibility requirements imposed by federal law, including Section 19 of the Federal Deposit Insurance Act."<sup>21</sup> The BLMA did not bring forward the Old Law's requirements that bank directors own qualifying shares, or "take and subscribe" an oath.<sup>22</sup>

### C. *Liability of Directors*

The BLMA confirms that bank directors are generally held to the same standard of conduct as directors of other corporations under Section 55-8-30 of the North Carolina Business Corporation Act.<sup>23</sup> The

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15. § 53C-4-2(e).

16. Compare N.C. GEN. STAT. §§ 53-80, -81 (repealed 2012), with N.C. GEN. STAT. § 53C-4-5 (Supp. 2012).

17. N.C. GEN. STAT. § 53C-4-5(a) (Supp. 2012). Under the Old Law, "no less than one-half" of a bank's directors were required to be residents of North Carolina "or any state in which the bank has a branch." N.C. GEN. STAT. § 53-80 (repealed 2012).

18. N.C. GEN. STAT. § 53C-4-2(b) (Supp. 2012).

19. N.C. GEN. STAT. § 53-67 (repealed 2012).

20. N.C. GEN. STAT. § 53C-4-2(b) (Supp. 2012).

21. § 53C-4-5(b). Section 19 of the Federal Deposit Insurance Act does not actually impose qualifications; it bars persons convicted of certain crimes from service. 12 U.S.C. § 1829(a) (2006).

22. Compare N.C. GEN. STAT. §§ 53-80, -81 (repealed 2012), with N.C. GEN. STAT. § 53C (Supp. 2012).

23. N.C. GEN. STAT. § 53C-4-6(a) (Supp. 2012) (referencing N.C. GEN. STAT. § 55-8-30). For discussion of the standards for directors under the North Carolina Business Corporation Act, see RUSSELL M. ROBINSON, II, ROBINSON ON N.C. CORP. L. §§ 14.01 – 14.06 (7th ed. 2012); see also *Atherton v. FDIC*, 519 U.S. 213, 227-28 (1997) (holding that the standard established in the Financial Institution Reform, Recovery, and Enforcement Act

BLMA also brings forward, in the same statute, a provision of the Old Law<sup>24</sup> that held directors liable for damages caused by a director's knowing violations of the North Carolina banking statutes.<sup>25</sup> The presence of this provision in the Old Law, standing alone, caused some concern that a court might find that it supplanted the North Carolina Business Corporation Act provision on director liability. Now that the provision follows the normal standard for directors, it should be seen simply as another exception to exculpation rather than an elevated standard of care mandated by statute. The North Carolina Business Corporation Act limits the effectiveness of exculpation provisions for certain violations, including acts or omissions a director knew were clearly in conflict with a corporation's best interests.<sup>26</sup> It would be possible, at least theoretically, for a director to believe that a violation of the banking laws was in a bank's best interests, but that unlikely hypothetical should be the full extent of any additional liability.

An amended Commission rule continues to require that, if a bank's articles of incorporation exculpate directors from liability, the exculpatory provisions limit exculpation "with regards to acts or omissions where the elimination of personal liability of directors would be contrary to the provisions of" the banking statutes.<sup>27</sup> It appears elimination of liability would be inconsistent only with the BLMA provision holding directors liable for knowingly permitting violations of Chapter 53C.<sup>28</sup>

#### D. Board Committee Structure

The BLMA continues the requirements of the Old Law that a bank's board establish executive, audit committee, and loan committees.<sup>29</sup> These committees need not have particular names, and the executive committee or the board as a whole may act as any or all of

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of 1989 does not preempt state law, but rather established a baseline standard for director negligence).

24. N.C. GEN. STAT. § 53-82 (repealed 2012).

25. N.C. GEN. STAT. § 53C-4-6(b) (Supp. 2012).

26. N.C. GEN. STAT. § 55-2-02(b)(3) (repealed 2012)

27. 04 N.C. ADMIN. CODE 03C .0112 (2012). See *infra* note 353 and accompanying text.

28. N.C. GEN. STAT. § 53C-4-6(b) (Supp. 2012).

29. Compare N.C. GEN. STAT. §§ 53-78, -83 (repealed 2012), with N.C. GEN. STAT. § 53C-4-3(a) (Supp. 2012).

these committees.<sup>30</sup> Although the full board of directors is required by statute to meet on at least a quarterly basis, executive committees are still required to meet during any month in which the full board of directors does not meet and loan committees are required to meet monthly.<sup>31</sup>

The Commissioner is empowered to require boards to establish other committees, taking into account various factors, including the asset size of the bank and the range and complexity of its activities.<sup>32</sup> “As part of its examination[] of a bank, the OCOB may assess the competence, composition, structure, and conduct” of its board of directors based on similar factors.<sup>33</sup> Given that the Commissioner now has this authority, it was illogical for the BLMA to bring forward the “one size fits all” approach to board governance requiring particular committees.

#### *E. Director Consent to Service of Process*

The BLMA requires that all bank directors appoint an agent for service of process in Wake County, North Carolina, or consent to the Commissioner serving as agent for service of process.<sup>34</sup> The intent of this statute was to subject directors to the jurisdiction of the Commissioner of Banks only in connection with proceedings brought by the Commissioner.<sup>35</sup> The Clarifications Bill may more clearly limit the statute to proceedings brought by the Commissioner and resolve some other ambiguities in the current wording.

#### *F. Affiliate Transactions*

The BLMA provides that banks may extend credit to and engage in transactions with directors and their “immediate family members only to the extent permitted by, and subject to such restrictions and conditions as are imposed by, applicable State and

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30. See N.C. GEN. STAT. § 53C-4-3(a) (Supp. 2012).

31. § 53C-4-2(c).

32. § 53C-4-3(b).

33. § 53C-4-10.

34. § 53C-4-5(c).

35. See *id.*



federal laws and regulations.”<sup>36</sup> The primary federal regulations governing transactions between banks and their affiliates are Regulation O<sup>37</sup> and Regulation W<sup>38</sup> of the Federal Reserve Board of Governors.

*G. Bank Officers and Employees*

The BLMA requires banks to bond their officers and employees as specified by the board of directors as to amount, form, and terms, but gives the Commissioner broad discretion to approve the form and amount of the bond and to require additional or other security.<sup>39</sup>

*H. Corporate Requirements*

The BLMA does not bring forward provisions of the Old Law requiring banks to hold annual meetings by June 30 and maintain shareholder records in a particular form.<sup>40</sup>

### III. CAPITAL, RESERVE, AND DIVIDENDS

*A. Bank Capital*

The BLMA provides for the regulation of bank capital in a manner similar to the Old Law, but eliminates the arcane metrics unique to the Old Law in favor of capital regulation based on federal prompt corrective action standards.<sup>41</sup>

#### 1. Capital Definitions

The BLMA capital provisions use six new defined terms:

36. § 53C-4-9.

37. 12 C.F.R. pt. 215 (2012) (governing loans to “insiders” and their “related interests”).

38. 12 C.F.R. pt. 223 (2012) (governing transactions, including loans, between banks and their affiliates).

39. § 53C-4-8.

40. Compare N.C. GEN. STAT. §§ 53-67, -85 (repealed 2012), with N.C. GEN. STAT. § 53C (Supp. 2012).

41. Compare N.C. GEN. STAT. § 53-1(4), (6), (9) (repealed 2012), with N.C. GEN. STAT. § 53C-1-4(12), (13), (41), (43), (62), (75) (Supp. 2012), and 12 C.F.R. pt. 325 (2012).

- “Capital,” which means an amount equal to the bank’s “total capital” as that term is used by the FDIC in Part 325 of its Regulations.<sup>42</sup>
- “Required Capital,” which means, for an existing bank, “an amount of capital equal to at least the amount . . . required for [the] bank to be [considered] ‘adequately capitalized’ under applicable federal regulatory capital standards.”<sup>43</sup>
- “Capital Impairment,” which means “[t]he reduction of a bank’s ‘capital’ . . . below its ‘required capital.’”<sup>44</sup>
- “Inadequate Capital,” which means “[a]n amount of capital equal to at least [75%,] but less than 100%, of ‘required capital.’”<sup>45</sup>
- “Insufficient Capital,” which means “[a]n amount of capital less than [75%] of ‘required capital.’”<sup>46</sup>
- “Well Capitalized,” which “has the same meaning as defined in the Federal Reserve Board’s Regulation Y.”<sup>47</sup> Under that definition, an insured bank is “well capitalized” if it “maintains at least the capital levels required to be [considered] well capitalized under the” bank’s federal regulatory agency’s capital adequacy regulations or guidelines.<sup>48</sup>

The BLMA includes provisions similar to those in the Old Law which condition a bank’s ability to engage, or the extent to which it may engage, in various activities, and its ability to obtain various required approvals of the Commissioner, on its “capital.” Though the BLMA

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42. N.C. GEN. STAT. § 53C-1-4(12) (Supp. 2012).

43. § 53C-1-4(62)(a). For a proposed bank, “required capital” means the amount of capital required by the Commissioner to commence business. *Id.*

44. § 53C-1-4(13) (alteration in original).

45. § 53C-1-4(41).

46. § 53C-1-4(43).

47. § 53C-1-4(75).

48. 12 C.F.R. § 225.2(r) (2012).

does not expressly require that capital be maintained at a particular level, it authorizes the Commissioner to take various enforcement actions if a bank's capital falls below its "required capital." So, banks essentially are required to remain at least "adequately capitalized."

## 2. Limitations on Certain Investments

Subsidiary Investments: The BLMA conditions a bank's ability to make an investment in a bank operating subsidiary, financial subsidiary, or DPC subsidiary,<sup>49</sup> or for a bank subsidiary to make an investment in a lower tier subsidiary,<sup>50</sup> on whether the bank will continue to satisfy, the BLMA "capital requirements."<sup>51</sup> The BLMA sets no statutory limits on subsidiary investments; however, a bank's investments are subject to safety and soundness supervision.

Portfolio Investments: The BLMA limits a bank's investment in bonds or debt obligations of any one person, other than obligations of the U.S. government or an agency thereof, or other obligations guaranteed by the U.S. or any state or political subdivision of any state, to 10% of the bank's "required capital."<sup>52</sup> Under the Old Law, these investments could not exceed \$50,000 plus 10% of all amounts in excess of \$250,000 of the bank's "unimpaired capital fund."<sup>53</sup> This change may result in a lower limit than the Old Law set. The Clarifications Bill may address this unintended consequence.

Reserve Banks: The BLMA limits a bank's investment in shares of a central reserve bank or bank organized under the Edge Act to 10% of the bank's "required capital."<sup>54</sup> The Old Law limited such an

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49. See *infra* notes 126-127 and accompanying text. DPC is the acronym for "debts previously contracted."

50. See *infra* notes 122-133 and accompanying text for discussion of different types of bank subsidiaries and requirements.

51. § 53C-5-2(c). Under the Old Law, a bank could invest: (1) without limit (a) in a corporation, firm, partnership or company that was a "bank operating subsidiary," which term was not defined, or (b) if the investment was made to protect the bank from loss; and (2) with prior notice to the Commissioner, up to an aggregate of 75% of the bank's "unimpaired capital fund" in other corporations, firms, partnerships or companies primarily engaged in activities (a) permissible for national banks or bank holding companies, (b) of a financial nature, or (c) approved by the Commissioner. N.C. GEN. STAT. § 53-47(b) (repealed 2012).

52. N.C. GEN. STAT. § 53C-5-2(j) (Supp. 2012).

53. N.C. GEN. STAT. § 53-46 (repealed 2012).

54. N.C. GEN. STAT. § 53C-5-2(a)(1)(b) (Supp. 2012).

investment to 10% of a bank's "paid-in capital and permanent surplus."<sup>55</sup> This change may result in a lower limit than the Old Law set.

### 3. Limitation on Loans to One Borrower

Under the BLMA, the total direct and indirect loans and extensions of credit to a single borrower may not exceed

- the greater of:

Fifteen percent of the bank's "capital," or

the percentage permitted for national banks

if the loans are not fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the aggregate outstanding loan amount, and

- Additionally, the greater of:

Ten percent of the bank's "capital," or

the percentage permitted for national banks

if the loans are fully secured by readily marketable collateral.<sup>56</sup>

Under the Old Law, loans to one borrower could not exceed fifteen percent of the bank's "unimpaired capital fund" or, if greater, the

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55. N.C. GEN. STAT. § 53-47(a) (repealed 2012).

56. N.C. GEN. STAT. § 53C-6-1(b) (Supp. 2012). These percentage limitations align with the loans to one borrower laws applicable to national banks, although the definitions of "capital" are not identical and, therefore, the limitations differ slightly when calculated. *See* 12 C.F.R. pt. 32.2-32.4 (2012) (specifying the manner in which lending limits applicable to national banks are to be calculated).

percentage permitted for national banks,<sup>57</sup> and up to an additional ten percent of the bank's "unimpaired capital fund" or, if greater, the percentage permitted for national banks.<sup>58</sup>

Although the BLMA did not change the percentage limitations, the new lending limit based on "capital" rather than "unimpaired capital fund" may result in a lower limit than the Old Law set. The Clarifications Bill may address this unintended consequence.

The Dodd-Frank Act amended Section 18 of the Federal Deposit Insurance Act to prohibit investments in derivative instruments by an insured state bank unless "the law with respect to lending limits of the State in which the insured State bank is chartered takes into consideration credit exposure to derivative transactions."<sup>59</sup> The BLMA defines "derivative transaction"<sup>60</sup> and specifically provides that "extensions of credit by a bank to a person shall include the bank's credit exposures to the person in derivative transactions with the bank."<sup>61</sup>

#### 4. Effects on Application and Notice Requirements

The level of a bank's "capital" affects whether the bank is required to obtain the Commissioner's advance approval in connection with certain matters.

A bank must apply to the Commissioner for approval before it engages in any new activity, either directly or through a new or existing subsidiary in which the bank intends to make an investment. However, if certain conditions are satisfied, including that the bank is "well-capitalized" and "well-managed,"<sup>62</sup> an after-the-fact notice may be given.<sup>63</sup>

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57. N.C. GEN. STAT. § 53-48(a) (repealed 2012).

58. § 53-48(b) (repealed 2012).

59. 12 U.S.C. § 1828(y) (Supp. V 2011).

60. N.C. GEN. STAT. § 53C-6-1(b)(4)(d) (Supp. 2012) ("any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to one or more commodities, securities, debt instruments, currencies, interest or other rates, indices, or assets").

61. § 53C-6-1(b)(4)(c).

62. As demonstrated by its most recent supervisory rating or the determination of the Commissioner in the absence of a rating. § 53C-1-4(76).

63. § 53C-5-2(f). *See infra* text accompanying notes 114-121 for general discussion of application requirements.

Before a bank invests in a subsidiary, or a bank subsidiary makes an investment in a lower tier subsidiary, the bank generally must give the Commissioner thirty days advance written notice and an opportunity to object. However, if certain conditions are satisfied, including that the bank is “well-capitalized” and “well-managed,”<sup>64</sup> a bank may give an after-the-fact notice.<sup>65</sup>

The BLMA also provides for the Commissioner to consider the level of a bank’s capital or the effects on a bank’s capital in connection with applications and notices pertaining to various matters, including new branch applications,<sup>66</sup> establishment on non-branch business offices,<sup>67</sup> change in control transactions,<sup>68</sup> subsidiary combinations,<sup>69</sup> and charter conversions.<sup>70</sup>

### 5. Commissioner’s Authority Relating to Capital

The BLMA authorizes the Commissioner to take various enforcement actions based on a bank’s capital level,<sup>71</sup> including cease and desist orders and civil money penalties,<sup>72</sup> “immediate action orders,”<sup>73</sup> supervisory control,<sup>74</sup> and receivership.<sup>75</sup>

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64. See *supra* note 622.

65. § 53C-5-2(f). See *infra* text accompanying notes 114-121 for fuller discussion of application requirements.

66. § 53C-6-15(e). See *infra* text accompanying notes 201-204 for fuller discussion of bank branches.

67. § 53C-6-18(a). See *infra* text accompanying notes 121, 182-200 for fuller discussion of non-branch business offices.

68. §§ 53C-7-104(b), -10-105(b). See *infra* text accompanying notes 273-319 for fuller discussion of changes in control.

69. § 53C-7-207(c). See *infra* text accompanying notes 253-262 for fuller discussion of subsidiary combinations.

70. § 53C-7-301(c). See *infra* text accompanying notes 354-377 for fuller discussion of charter conversions.

71. See *infra* notes 419-474 and accompanying text for a fuller discussion of the Commissioner’s enforcement authority.

72. § 53C-8-12(c), (f), (h). Though this provision does not specifically mention “capital,” issues relating to a bank’s capital could give rise to violations or unsafe or unsound courses of conduct and be the subject of orders and civil money penalties.

73. § 53C-8-13(a) (“inadequate capital” or “insufficient capital”).

74. § 53C-8-14(a) (“insufficient capital”).

75. § 53C-9-301(a) (“capital of the bank [so] impaired [that] the likely realizable value of [the bank’s] assets is insufficient to pay and satisfy the claims of all depositors and all creditors”).

## 6. Old Law Provisions not Brought Forward

The following provisions of the old law have no counterpart in the BLMA:

Equity Compensation: The Old Law provided that banks could (1) grant options to directors, officers, and employees to purchase stock for 100% of the fair market value when granted, or (2) establish stock purchase plans allowing bank officers and employees to buy bank stock at a discount of no more than fifteen percent. Stock option plans could be adopted only with the approval of two-thirds vote of the holders of the class of stock affected.<sup>76</sup> OCOB interpreted this statute to provide the exclusive means for banks to provide equity compensation. These limitations did not apply to bank holding companies.<sup>77</sup>

The BLMA contains no such restriction. Flexibility with respect to equity compensation may remove an incentive for a bank to form or maintain a bank holding company.<sup>78</sup>

Suspension of Limits on Loan and Investments: The BLMA did not bring forward a provision of the Old Law<sup>79</sup> allowing the Commissioner to suspend statutory limits on loans and investments. The Clarifications Bill may address this omission.

Capital Impairment Assessments: Under the Old Law, the Commissioner could require a bank with a capital impairment to assess its shareholders. If an assessment was made and a shareholder failed to pay it, the bank was required to sell the shareholder's stock.<sup>80</sup>

Investments in Bank Premises: The Old Law limited a bank's investment in real estate necessary for the transaction of its business, including furniture and fixtures, with its banking offices and other spaces to rent, to 50% of its "unimpaired capital fund."<sup>81</sup>

Use of Surplus: The Old Law provided that a bank could not

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76. N.C. GEN. STAT. § 53-43.3 (repealed 2012). The Old Law also provided a mechanism for banks to increase authorized stock free of preemptive rights to issue under stock option or stock purchase plans. *Id.* § 53-10 (repealed 2012). The BLMA did not bring this provision forward.

77. *See infra* Part VII.A.2.

78. *See infra* notes 227-9 and accompanying text discussing the removal of the super majority voting requirement for mergers involving banks, which also may reduce incentives for banks to form or maintain bank holding companies.

79. N.C. GEN. STAT. § 53-49 (repealed 2012).

80. § 53-42 (repealed 2012).

81. § 53-43(3) (repealed 2012).

convert “surplus” into capital stock as a stock dividend if that would reduce its surplus to an amount below 50% of its “paid-in capital.”<sup>82</sup>

Publishing Summary Reports of Condition: The Commissioner could require banks to publish summaries of their December 31 statements of condition in newspapers published in the counties where they were located.<sup>83</sup>

#### *B. Reserve Fund Requirements*

The BLMA requires a bank to maintain a reserve fund equal to: (1) for member banks, the reserve required by FRB regulations; or (2) for non-member banks, the reserve set by the Commissioner, taking into consideration the level of liquidity deemed necessary for the safe and sound operation of banks.<sup>84</sup> Reserves may include: (a) cash on hand, including exchange of any clearing house association or similar intermediary; (b) balances on demand from designated depository institutions; and (c) obligations of the U.S. Treasury, any U.S. agency that is guaranteed by the U.S. government, and a general obligation of North Carolina or any of its political subdivision rated “A” or higher by a nationally recognized rating service.<sup>85</sup>

The Old Law’s reserve provisions<sup>86</sup> were similar to these provisions, but more verbose, and it appears no substantive change was intended. Unlike the BLMA, the Old Law expressly permitted balances held at a federal reserve bank to be counted as part of a bank’s reserve. If a federal reserve bank is approved as one of the bank’s “designated depository institutions,” then balances held there would be includable if they are considered demand deposits; however, this is unclear. Federal Reserve balances may be addressed in the Clarifications Bill.

The BLMA does not bring forward the provision of the Old Law requiring that government securities be unencumbered, interest-bearing, and have remaining maturities of less than 120 days, or that the amount

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82. § 53-88 (repealed 2012). This provision required many banks during the Great Recession to amend their articles of incorporation in order to reduce the par value of their common stock. “Par value” was a concept that had long since ceased to exist under the North Carolina Business Corporation Act, but which still applied to banks under the Old Law.

83. § 53-105 (repealed 2012).

84. N.C. GEN. STAT. § 53C-4-11(a) (Supp. 2012).

85. § 53C-4-11(c).

86. N.C. GEN. STAT. §§ 53-50, 53-51 (repealed 2012).



of those securities be limited to the percentage set by the Commission. The Commission rule which imposed these limits has been repealed.<sup>87</sup>

### C. *Dividends and other Distributions*

The BLMA permits a bank's Board to declare "distributions" as it deems proper, provided that the "bank does not make distributions that reduce its capital below its 'required capital.'"<sup>88</sup>

The BLMA provides that "distributions" has the same meaning as set forth in the North Carolina Business Corporation Act.<sup>89</sup> Chapter 55 defines "distribution" to include any transfer of property (other than share issuances) in respect of any outstanding shares, including both payment of a cash dividend and a purchase, redemption, or other acquisition of its shares.<sup>90</sup>

Dividends: The Old Law required a calculation based on definitions unique to North Carolina banking law.<sup>91</sup> The BLMA's only limitation is maintaining required capital, but restrictions on dividends under federal banking regulations and the North Carolina Business Corporation Act also apply. Further, a bank's payment of dividends continues to be subject to the Commissioner's authority to bring an enforcement action in response to safety and soundness concerns.

Share Redemptions: The Old Law apparently permitted a bank to reduce its "capital stock" (which was interpreted to include a repurchase of shares), provided that: (1) capital stock could not be reduced below "the amount required by law," and (2) any reduction in capital stock had to be approved by both the Commissioner and a vote of two-thirds in interest of each class of stockholders with voting powers.<sup>92</sup>

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87. 04 N.C. ADMIN. CODE 03C.1403 (repealed 2013).

88. N.C. GEN. STAT. § 53C-4-7 (Supp. 2012) (quotations added). *See supra* note 43 and accompanying text for discussion of "required capital."

89. § 53C-1-4(29).

90. N.C. GEN. STAT. § 55-1-40(6) (2011). The definition also includes a corporation's issuance of debt to its shareholders.

91. N.C. GEN. STAT. § 53-87 (repealed 2012). A bank could declare a "dividend" of so much of the bank's "undivided profits" as they deemed expedient. However, if the bank's "surplus" was less than 50% of its "paid-in capital stock," a dividend could not be declared until the bank had transferred from undivided profits to surplus 25% of undivided profits, or any lesser percentage required to restore surplus to an amount equal to 50% of paid-in capital.

92. § 53-11 (repealed 2012). Another provision of the Old Law related to loans

The BLMA's only limitation is maintaining required capital, but restrictions on share repurchases under federal banking regulations and the North Carolina Business Corporation Act apply. Also, a bank's payment of dividends continues to be subject to the Commissioner's authority to bring an enforcement action in response to safety and soundness concerns.

#### IV. POWERS, ACTIVITIES, AND INVESTMENTS

##### A. *Summary*

Under the Old Law, formal applications to the OCOB were not required for new activities generally, but were required whenever banks created various types of subsidiaries. Under the BLMA, notices may be required whenever a bank conducts a new activity, whether or not it organizes a subsidiary. Well-managed and well-capitalized banks often will have only an after-the-fact notice requirement for new activities, even when they organize a new subsidiary for the activity. However, prior notices or applications may be required for well-managed and well-capitalized banks if the new activity will be conducted on new premises. There are certain complexities and ambiguities in these statutes, as discussed below.

##### B. *Federal Law Overlay*

A bank conducting a new activity always must consider applicable federal law. Under Section 24 of the Federal Deposit Insurance Act<sup>93</sup> and its implementing regulations,<sup>94</sup> state banks, with certain exceptions,<sup>95</sup> are limited to conducting the "principal" activities, and making the investments, that national banks are permitted to make.

National banks are, by definition, creatures of limited powers,

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secured by a bank's own stock or that of its parent holding company apparently prohibited a bank from purchasing any shares of its own stock or its parent holding company. It provided a confusing exception for "purchasing" stock on account of debts previously contracted. § 53-64(c) (repealed 2012).

93. 12 U.S.C. § 1831a (2006).

94. 12 C.F.R. pt. 362 (2012).

95. The FDIC also may permit an insured state bank to engage in an activity that the FDIC determines would pose no significant risk to the Deposit Insurance Fund, provided the bank is in compliance with applicable capital standards. 12 U.S.C. § 1831a(a)(1) (2006).

and only have the power to engage in activities that are permitted by the statutes and regulations that govern them. The history of national bank regulation is awash in creative arguments that various activities are “part of” or “incidental to” the business of banking and therefore permissible under the National Bank Act. Banking lawyers, both within the Office of the Comptroller of the Currency (OCC) and in the private sector, pursue these arguments with the fervor of theologians. Their efforts have resulted in the creation of a long list of permissible activities based on statutes, regulations, or OCC interpretations.<sup>96</sup>

Section 24 of the FDIA does not generally limit the “agent” activities in which a bank may engage. For example: although Section 24 prevents banks from engaging in most real estate investments and most insurance underwriting,<sup>97</sup> it does not prevent a state bank from acting as a real estate agent or as an insurance agent.

A comprehensive treatment of the federal law on bank activities and investments is beyond the scope of this article.

### C. *Prior North Carolina Law*

Under the Old Law, North Carolina banks were not creatures of limited powers, so no distinction was drawn between activities engaged in “as principal” and those engaged in “as agent.” North Carolina banks have engaged in agency activities impermissible for national banks for many years. No application to the OCOB was required in order to engage in an activity directly, although these activities were subject to the Commissioner’s supervision.

The Old Law<sup>98</sup> and its regulations<sup>99</sup> required a state bank to apply to the Commissioner to engage in an activity only if it wanted to conduct them in certain subsidiaries. A bank could “invest without limit” in an “operating subsidiary” or “to protect against loss,”<sup>100</sup> but the Old Law did not define “operating subsidiary.” The Old Law also gave

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96. The OCC maintains a list of activities and investments that are permissible for national banks, which is available on its website: <http://www.occ.treas.gov/publications/publications-by-topic/laws-and-regulations/index-laws-and-regulations-pubs.html>.

97. 12 C.F.R. pt. 362 provides for some limited exceptions to these general prohibitions.

98. N.C. GEN. STAT. § 53-47 (repealed 2012).

99. 04 N.C. ADMIN CODE 03C.0807 (2012).

100. N.C. GEN. STAT. § 53-47(b) (repealed 2012).

the Commissioner the authority to allow a bank to create a subsidiary, subject to certain capital limits, to engage in activities “permissible for national banks or bank holding companies,”<sup>101</sup> or “of a financial nature,”<sup>102</sup> and “any other activity approved by the Commissioner of Banks.”<sup>103</sup>

#### D. *The BLMA Provisions – Generally*

The BLMA includes two statutes governing bank activities and investments. The first one (the Powers Statute) addresses a bank’s power to engage in certain activities either directly or through a subsidiary.<sup>104</sup> The second one (the Investment Statute) addresses both “passive” investments (discussed below) and “activity” type investments.<sup>105</sup> These two statutes frequently overlap, creating some complexities and ambiguities.<sup>106</sup>

#### E. *The Powers Statute*

##### 1. Powers

The Powers Statute first provides that “a bank shall have the powers conferred upon business corporations organized under the law of this State,”<sup>107</sup> so it appears that banks continue to be creatures of unlimited powers under North Carolina law, subject of course to supervision. The BLMA explicitly provides that the Commissioner may permit a bank to engage in any activity “by rule, order, or interpretation.”<sup>108</sup>

The Powers Statute also provides that in addition to its regular

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101. § 53-47(c)(1) (repealed 2012).

102. § 53-47(c)(2) (repealed 2012).

103. § 53-47(c)(3) (repealed 2012).

104. N.C. GEN. STAT. § 53C-5-1 (Supp. 2012).

105. *Id.*

106. Generally, a “power” is what a bank or bank affiliate is or may be allowed to do under statutes applicable to that entity. Depending on the statute being considered, the exercise of a power may be classified as an “activity,” as an “investment,” or as both. There is not a hard and fast distinction between “activities” and “investments” in most statutes that apply to banking organizations.

107. § 53C-5-1(a) (Supp. 2012); *see supra* Part IV.B for discussion of federal law limitations.

108. § 53C-5-1(a)(7).

corporate powers, a bank has the power to engage in three broad groups of activities. First, a bank has the power to engage in a number of traditional banking activities.<sup>109</sup> Second, a bank has the power to engage:

- “as principal” in any activity allowed for national banks;
- “as principal” in any activity permissible under, or “determined by the FDIC to be permissible,” under Section 24 of the Federal Deposit Insurance Act;
- “as principal” in any activity determined to be permissible for thrifts under federal or state law; and
- as an agent, in any activity permitted under Section 24 of the Federal Deposit Insurance Act.<sup>110</sup>

Third, a bank has the power to engage in activities reasonably necessary to exercise powers in either of the first two categories.<sup>111</sup>

## 2. Application vs. After-the-Fact Notice

The BLMA requires an application for certain “new” activities whether or not they are conducted in a subsidiary. The law explicitly provides that, with certain exceptions, any bank that proposes to engage in any “new activity” must first apply to the OCOB. A “new activity” is any business activity in which the bank is not currently engaged.”<sup>112</sup> If the bank proposes to engage in the new activity through a subsidiary, it must apply to the OCOB before making the investment in a new subsidiary or investing further for that activity in an existing subsidiary.

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109. § 53C-5-1(a).

110. § 53C-5-1(b).

111. § 53C-5-1(c). Section 24 of the Federal Deposit Insurance Act, 12 U.S.C. 1831a, does not actually permit any activity; rather it prohibits certain as principal activities and does not address agency activity. The FDIC does not generally issue determinations under Section 24. The statute could be better worded, but the meaning appears to be an agency activity not prohibited by the FDIC, which means essentially any agency activity.

112. § 53C-5-1(d).

On the other hand, if a bank moves an existing activity into a new department, division, or subsidiary, that movement does not make the activity a “new” one requiring an application.<sup>113</sup>

The BLMA provides a very sensible set of exceptions to the new activity application requirement. A bank does have to apply if:

- the activity is one of those described in preceding sections of the statute;
- the bank is well-capitalized and well-managed based on its last examination; *and*
- no federal application is required.<sup>114</sup>

A bank exempt from the prior approval requirements under the Powers Statute must give the OCOB notice of the new activity within 30 days of the earlier of starting the activity or investing in a subsidiary in which the activity will be conducted.<sup>115</sup>

Starting a trust department or trust company is not an activity for which a bank may give after-the-fact notice, even if the bank’s articles of incorporation recite that it may conduct a trust business. To start a corporate fiduciary business, a bank must proceed under Article 14 of Chapter 53 of the North Carolina General Statutes (which the BLMA has not repealed or amended) and, if it is not a Federal Reserve member bank, obtain the FDIC’s consent to exercise trust powers.<sup>116</sup> To start a subsidiary trust company, a bank would have to proceed under Article 24 of Chapter 53 of the North Carolina General Statutes (which the BLMA also has not repealed or amended).

### 3. New Non-Branch Bank Business Office – Prior Notice Requirements

As discussed below,<sup>117</sup> a North Carolina bank ordinarily is only required to give notice of intent to open a “non-branch bank business office.”<sup>118</sup> However, if “a product, service, or other type of business not

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113. *Id.*

114. § 53C-5-1(e).

115. § 53C-5-1(f).

116. 12 C.F.R. § 303.242 (2012).

117. See discussion *infra* Part V.B.

118. Defined as an office at which no deposits are taken. N.C. GEN. STAT. § 53C-1-4(46) (Supp. 2012). The statute governing non-branch bank business offices also requires

previously engaged in by the bank” is offered at a new non-branch business office, a ten day prior notice is required even if a bank is well-capitalized and well-managed and the activity is on the list for which only after-the-fact notice otherwise would be required.<sup>119</sup>

It is unclear whether a bank that is not well-capitalized or well-managed is able to shorten the 30-day notice for a new activity to 10 days by commencing the activity in a new building. The Clarifications Bill may address this ambiguity.

#### *F. The Investment Statute*

##### 1. Subsidiary Categories

The Investment Statute also addresses subsidiary investments, and in particular contexts questions will arise whether the Investment Statute or the Powers Statute applies, or whether both apply. The Investment Statute authorizes a bank to invest in:

- A “bank operating subsidiary,”<sup>120</sup>
- A “financial subsidiary,”<sup>121</sup> and
- A “DPC subsidiary.”<sup>122</sup>

A “bank operating subsidiary” is defined as a subsidiary “under the control of a bank” which “engages only in activities in which a bank may engage” under the Powers Statute.<sup>123</sup> A bank operating subsidiary under the BLMA may engage in any of the broad activities permissible under the Powers Statute. A national bank’s operating subsidiary may only engage in the more limited activities in which national banks may engage directly.<sup>124</sup>

The definition of “control” includes the power to direct management or policies “through the ownership of or voting power over

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that no deposits be taken at those offices. § 53C-6-18(d).

119. § 53C-6-18(a).

120. § 53C-5-2(b)(1).

121. § 53C-5-2(b)(2).

122. § 53C-5-2(b)(3).

123. § 53C-1-4(5).

124. 12 C.F.R. § 5.34(e) (2012).

ten percent” of an entity’s voting securities.<sup>125</sup> This statute may create a *de facto* presumption that ten percent ownership entails control, so banks which might invest to that degree in an entity they do not consider a subsidiary will need to carefully consider the Investment Statute.<sup>126</sup>

A “financial subsidiary” is defined by reference to federal law as a “company controlled by one or more depository institutions” which engages in activities that are “financial in nature” other than those:

- in which a national bank may engage directly, or
- in which a national bank is specifically authorized to engage by the express terms of a federal statute.<sup>127</sup>

A “DPC subsidiary” is defined as a subsidiary which holds collateral acquired as a result of debts previously contracted (“DPC”).<sup>128</sup> A “DPC subsidiary” is really a just a species of “bank operating subsidiary” because holding DPC collateral is permitted under the Powers Statute.<sup>129</sup> This separate definition within the statute was technically unnecessary.

The BLMA also defines a “lower-tier subsidiary” as a “bank operating subsidiary in which a bank subsidiary has an equity ownership interest,”<sup>130</sup> and provides that “a bank operating subsidiary may make an investment of any size in a lower tier subsidiary.”<sup>131</sup> These two provisions create many ambiguities. The BLMA defines a “subsidiary” as any “company over which a bank has control,”<sup>132</sup> and defines “control” to include direct or indirect power to control

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125. § 53C-1-4(21).

126. As a practical matter, the “federal law overlay” discussed *supra* Part IV.B will limit minority investments in most subsidiaries.

127. § 53C-1-4(38) (referencing 12 U.S.C. § 24a(g) (2006)).

128. § 53C-1-4(30).

129. The Old Law established holding periods for DPC property. N.C. GEN. STAT. § 53-43(3)(c) (repealed 2012). The BLMA establishes a similar limit. N.C. GEN. STAT. § 53C-5-2(i) (Supp. 2012). The National Bank Act establishes holding periods for DPC property, 12 U.S.C. § 29 (2006), which the Federal Deposit Insurance Act and FDIC regulations make applicable to banks. 12 U.S.C. § 24; 12 C.F.R. pt. 362 (2012).

130. N.C. GEN. STAT. § 53C-1-4(44) (Supp. 2012).

131. § 53C-5-2(d) (the failure to use the hyphen used in the definition is a scrivener’s error).

132. § 53C-1-4(68).



“through” ownership of ten percent of voting securities.<sup>133</sup> Therefore, a “lower-tier subsidiary” is a species of “subsidiary,” but the definition of “lower-tier subsidiary” is so broad that it might be read to include a passive investment by a bank’s subsidiary. Also, the BLMA leaves unclear whether a lower-tier subsidiary is subject to the same requirements as a direct subsidiary, and leaves unclear whether the OCOB’s authority extends to subsidiaries of a lower-tier subsidiary. The Clarifications Bill may address these ambiguities.

## 2. Overlap Ambiguities

The Powers Statute allows a bank to engage, either directly or through a subsidiary, in a number of activities permissible for banks, which include those of “bank operating subsidiaries” and “DPC Subsidiaries.” This overlap between the Powers Statute and the Investment Statute creates the ambiguities discussed below.

Prior Notice Requirements: As under the Powers Statute, if a bank meets certain criteria, including being “well-managed” and “well capitalized,” it only needs to give the OCOB after-the-fact notice if it engages in a “new activity.” The Investment Statute, however, imposes this additional criterion for giving an after-the-fact notice: the activity must be either “[o]ne in which the bank is then engaged or has previously been engaged, directly or through a different subsidiary, and for which all necessary approvals of bank supervisory agencies and of the Commissioner have previously been obtained and remain in effect,”<sup>134</sup> or “[o]ne for which no prior notice or application for approval to any federal bank supervisory authority is required.”<sup>135</sup>

So, under the Powers Statute it appears well-capitalized and well-managed banks may organize certain subsidiaries to engage in new activities and give an after-the-fact notice. Under the Investment Statute, it appears that such a bank must give 30 days prior notice of a new activity in a subsidiary if (A) it has never engaged in the activity before, and (B) a prior notice is required to a federal banking regulator.

As a practical matter, not many activities in which state banks wish to engage require prior notice to a federal banking regulator.

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133. § 53C-1-4(21).

134. § 53C-5-2(f)(2)a.

135. § 53C-5-2(f)(2)b.

There are exceptions, such as offering courier services<sup>136</sup> or exercising trust powers.<sup>137</sup> In those cases, it is not clear why prior notice should depend on whether the activity is conducted in a subsidiary.

Additional Requirements for Subsidiaries: The Investment Statute imposes these additional requirements for a subsidiary which are not included in the Powers Statute:

- Board of directors approval;
- Careful investigation of the activity by the bank officers;
- Establishment of risk management and financial controls necessary for safe and sound operation;
- Continued satisfaction of Chapter 53C capital requirements.<sup>138</sup>

Whether an executive or other authorized committee could give the required approval is not clear, but that should be the interpretation under the North Carolina Business Corporation Act.<sup>139</sup> Presumably a well-run bank would always meet the other requirements of this statute for any new activity, whether or not that new activity is conducted through a subsidiary. It is illogical, however, for these requirements to apply to the organization of a subsidiary but not the commencement of a new activity without a subsidiary.

Accounting and Regulatory Treatment: The Investment Statute provides that investments in subsidiaries “shall receive the same accounting and regulatory treatment as is accorded to such investment by the bank’s primary federal supervisor.”<sup>140</sup> It is not clear what the drafters intended this provision to achieve. North Carolina law cannot affect the accounting and regulatory treatment imposed by the federal banking laws. And the OCOB undoubtedly wishes to apply its own

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136. 12 C.F.R. pt. 303, Subpart C. North Carolina Administrative Code provisions require compliance with FDIC regulations and the requirements of the North Carolina Private Protective Services Act. 04 N.C. ADMIN. CODE 03C.1802 (2012).

137. 12 C.F.R. § 303.242 (2012) (applicable to state nonmember banks).

138. N.C. GEN. STAT. § 53C-5-2(c) (Supp. 2012).

139. § 55-8-25 (providing for the board to act through committees). The North Carolina Business Corporation Act applies to banks except where the BLMA provides differently. § 53C-4-1(b). It could be argued that the BLMA requires full board approval, but the interpretation that the committee provision is incorporated is more logical.

140. § 53C-5-2(c).

accounting and regulatory standards, not those of the federal regulators. The Clarifications Bill may address this ambiguity.

### 3. Illustrative Example of Certain Ambiguities

Suppose a bank wants to start an insurance agency, and has never been in the insurance business. Now suppose the bank elects to sell insurance through a division of the bank, rather than creating a subsidiary, and is going to use existing bank premises: if it is well-capitalized and well-managed, it may give an after-the-fact notice.

Suppose instead that the bank is going to set up the agency in a new office building it is buying. In that case, it appears the bank must give a 10 day prior notice because of the new non-branch office. It appears, however, that if the bank starts the agency in existing premises, and waits a decent interval, it could move it to the new office without further notice because relocation of an existing activity is apparently not a new activity, and no application is required simply to buy the new non-branch building.

Suppose the bank decides to start the new insurance agency in a subsidiary it organizes. As no prior notice is required under federal law, the bank only has to provide the OCOB an after-the-fact notice. A careful bank would give the notice pursuant to both the Powers Statute and the Investment Statute, but the notice amounts to the same thing. And now the bank may be required to show that the board of directors approved the subsidiary after careful investigation of the activity by bank officers, establishment of risk management and financial controls, and confirmation that the bank will continue to satisfy capital requirements.

Now suppose the bank has limited its insurance business to property and casualty insurance, but wishes to add life and health insurance as a new product line. Unfortunately, that bank just missed being “well capitalized” in its last examination. Is adding life and health insurance a “new activity” that now requires an application? The answer is not clear.

#### *G. The Investment Statute – Passive Investments*

The Investment Statute also sets forth rules about the securities

in which banks may invest and the real estate it may acquire. The statute will have limited practical effect on those issues, because federal law limits state bank investments in securities and real estate to the investments national banks may make.

The Investment Statute and the statute which follows its list a number of permitted securities investments, including government and agency securities in which banks traditionally have invested.<sup>141</sup> It also allows banks to invest in “mutual funds,” subject to rules or orders of the Commissioner.<sup>142</sup> Under the federal law overlay discussed above,<sup>143</sup> state banks generally may not invest in equity mutual funds. The Investment Statute also allows investments in “other depository institutions” and “industrial banks” and similar entities, subject to a limit of ten percent of “required capital.”<sup>144</sup>

It does not appear the Investment Statute is intended generally to impose limits on investments beyond those of federal law, as the list of permissible investments is “in addition to any powers or investments authorized by any other section of this Chapter.”<sup>145</sup> The BLMA does not explicitly distinguish an “activity” from an “investment,” so presumably the activity of investing in securities in which national banks may invest is covered by the Powers Statute. And the Investment Statute explicitly provides that a bank may invest in “[a]ny company in which a federally chartered institution is authorized to invest under any statute or any regulation, official circular, bulletin, order, or written interpretation issued by the OCC.”<sup>146</sup>

The Investment Statute does impose a limit of 10% of “required capital” in the bonds or debts of any one person, with exceptions for securities guaranteed by the United States, a state, or a political subdivision of a state.<sup>147</sup> National banks, of course, also have percentage concentration limits.<sup>148</sup>

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141. N.C. GEN. STAT. § 53C-5-2(a)(2)–(5) (Supp. 2012); § 53C-5-3.

142. § 53C-5-2(a)(6). No such rules have been promulgated.

143. See *supra* Part IV.B.

144. § 53C-5-2(a)(1). See *supra* Part III.A.2 for fuller discussion of this limitation.

145. § 53C-5-2(a).

146. § 53C-5-2(a)(1)(c). It would be a good clarification to broaden this provision to cover all investments allowed for a national bank or under FDIC law, in a manner similar to the Powers Statute provision in section 53C-5-1(b)(1) and (2). The Clarifications Bill may address this matter.

147. § 53C-5-2(j). See *supra* Part III.A.2 for fuller discussion of this capital limitation.

148. See 12 C.F.R. pt. 1 (2012).

The Investment Statute specifically authorizes banks to hold real estate as security and to exercise its rights in that security after default.<sup>149</sup> Additionally, “bank premises” continues to be defined so as to include real estate intended for future expansion “including additional space to rent as a source of income.”<sup>150</sup>

#### *H. Out-of-State Banks*

The BLMA also attempts to level the playing field for out-of-state banks which need a license from a North Carolina agency to conduct a non-bank activity:

Any bank, out-of-state bank, national bank, or any subsidiary thereof that engages in an activity subject to licensure and/or regulation under the laws of this State, other than this Chapter, shall be subject to licensure and/or regulation on a basis that does not arbitrarily discriminate by the appropriate regulatory agency which licenses and/or regulates nonbanks that engage in the same activity.<sup>151</sup>

This provision may be helpful to out of state banks seeking licensures for non-bank activities in North Carolina. It also may be useful to a North Carolina bank or subsidiary seeking licensure for non-bank activities outside of North Carolina where proof of reciprocity is a condition of that licensure.

### V. OPERATIONS

Article VI of the BLMA is titled, and governs certain, “Bank Operations.” In general, the BLMA made no big changes in laws governing bank operations, but it made some clarifying improvements favorable to banks. The Clarifications Bill may make some further improvements in some of these statutes.

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149. § 53C-5-2(i).

150. § 53C-1-4(6).

151. § 53C-5-2(g).

A. *Deposit Accounts and Safe Deposit Boxes*

The BLMA made a number of improvements in statutes governing minor, joint, payable on death, and agency deposit accounts. Banks should update their deposit account agreement provisions to include these new statutory references. Banks also should review relevant portions of their deposit account agreements and update them to mesh, rather than appearing to conflict in any way, with the protections provided in these new statutes.

1. Accounts for Minors

The Old Law provided that banks could deal with minors in deposit and safe deposit accounts “with the same effect upon its liability as if such minors were of full age.”<sup>152</sup> The BLMA statute contains improved language. It provides that banks may deal with minors, and that minors are bound by contracts, as if and to the same extent as “such minors were of full age *and legal capacity*.”<sup>153</sup> It also provides that “[a]ny payment to or at the direction of a minor is a discharge of the bank to the extent thereof.”<sup>154</sup> A bank is also allowed to pay the balance owed a deceased minor to the minor’s parent or legal guardian and be discharged, unless the account is a joint or payable on death account.<sup>155</sup> It is unfortunate that the BLMA does not include a similar provision for a deceased minor’s safe deposit box.<sup>156</sup>

The BLMA also includes default provisions for an account opened by an adult in the name of a minor that clarify ambiguities that arose under the Old Law. Subject to certain exceptions, control of such an account vests exclusively in the “custodian whose name appears on the bank’s records for the account,” and if there is more than one custodian, each may act independently.<sup>157</sup> The exceptions to exclusive control by the custodian are: (1) the custodian may turn over control to the beneficiary before or after the beneficiary reaches majority;<sup>158</sup> and

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152. N.C. GEN. STAT. § 53-43.5 (repealed 2012).

153. N.C. GEN. STAT. § 53C-6-4(a) (Supp. 2012) (emphasis added).

154. *Id.*

155. § 53C-6-4(c).

156. *See* § 53C-6-4(b).

157. § 53C-6-9(a)(2).

158. *Id.*

(2) the beneficiary may instruct the bank to remove the custodian's authority when the beneficiary reaches majority.<sup>159</sup> Because a custodian's control is exclusive subject to these exceptions, a bank is not responsible for continuing to deal with a custodian after the beneficiary reaches majority unless the beneficiary instructs the bank to cease dealing with that custodian. Another provision instructs the bank to deal with the minor's parent or legal guardian if the custodian dies.<sup>160</sup>

## 2. Joint Accounts, Payable on Death Accounts, and Agency Accounts

The BLMA recodified and updated the Old Law's provisions on non-exclusive statutory joint accounts,<sup>161</sup> payable on death accounts,<sup>162</sup> and personal agency accounts<sup>163</sup> to address questions that had arisen under the Old Law.

Joint Accounts: One improvement provides that a bank is not liable to one joint tenant for complying with legal process seeking funds in the name of another joint tenant.<sup>164</sup> The BLMA also makes clear that any joint tenant may terminate a joint account,<sup>165</sup> and provides that a joint tenant may be removed from a joint account upon request.<sup>166</sup>

Payable on Death Accounts: The BLMA made no substantive change to the provisions of the Old Law.<sup>167</sup>

Personal Agency Accounts: The BLMA added provisions that make clear that duly appointed guardians may terminate an agent's authority.<sup>168</sup>

Bank deposit agreements for these types of accounts are supposed to have specific language that refers to the particular statutes governing these accounts. The BLMA provides that references in account agreements to the old joint account<sup>169</sup> and personal agency

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159. § 53C-6-9(a)(3).

160. § 53C-6-9(a)(4).

161. N.C. GEN. STAT. § 53-146.1 (repealed 2012).

162. § 53-146.2 (repealed 2012).

163. § 53-146.3 (repealed 2012).

164. § 53C-6-6(e).

165. § 53C-6-6(h).

166. § 53C-6-6(i).

167. § 53C-6-7.

168. § 53C-6-8(d). There is a scrivener's error in the statute that refers to a guardian acting pursuant to a power of attorney, which the Clarifications Bill may correct.

169. § 53C-6-6(j).

account<sup>170</sup> statutes will be deemed to refer to the new statutes. This language was inadvertently omitted in the new payable on death account statute,<sup>171</sup> but that minor omission may be cured in the Clarifications Bill.

### 3. Power of Attorney Accounts

Another provision of the BLMA protects banks dealing with attorneys-in-fact. It provides that a bank is not liable for continuing to deal with a person who was an attorney-in-fact when no notice of revocation of the power of attorney, and allows payment of items drawn on an account that are properly payable for a period of ten days following notice of revocation.<sup>172</sup>

### 4. Facility of Payment

The BLMA added a facility of payment provision making clear that a bank is discharged from liability when it pays funds to the personal representative of a deceased person or to a person appointed as a guardian or conservator of the account owner, and allowing a bank to rely conclusively on a letter of qualification of a personal representative.<sup>173</sup>

### 5. Collateralized Deposits

The BLMA authorizes a bank to pledge its assets to secure deposits of public funds,<sup>174</sup> but only when authorized or required by applicable law.<sup>175</sup> The BLMA declares any other pledge to secure a deposit void.<sup>176</sup> The BLMA did not bring forward provisions of the Old Law providing that certain securities were eligible as collateral deposits notwithstanding any other law.<sup>177</sup>

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170. § 53C-6-8(g).

171. § 53C-6-7.

172. § 53C-6-11.

173. § 53C-6-10.

174. § 53C-6-3(b).

175. § 53C-6-3(a).

176. § 53C-6-3(d).

177. *E.g.*, N.C. GEN. STAT. §§ 53-43.1, -43.2, -45(d) (repealed 2012).



## 6. Safe Deposit Boxes

BLMA brings forward the provisions of the Old Law governing safe deposit boxes,<sup>178</sup> but with non-substantive changes including a more logical arrangement of statutory subdivisions.<sup>179</sup>

### *B. Non-Branch Bank Business Offices*

The Old Law defined a “branch” as “an office of any bank in which deposits are received, monies are paid, and loans are made.”<sup>180</sup> The BLMA defines “branch” as any “office of any bank or a depository institution . . . in which deposits are received.”<sup>181</sup> It also provides that other activities may take place in branches.<sup>182</sup> The BLMA branch definition also makes clear that a non-branch bank business office, automated teller machine, remote deposit facility, and other items are not branches.<sup>183</sup>

The Old Law defined a “limited service facility” as “an office of a bank in which deposits are received, monies are paid, or other duties and functions of a teller are performed.”<sup>184</sup> It prohibited the execution of notes or the disbursement of loan proceeds in such an office.<sup>185</sup> The BLMA replaces “limited service facility” with the term “non-branch bank business office,” which is defined as a “staffed physical location open to the public in this State . . . at which one or more banking or banking-related products or services are offered, other than the taking of deposits.”<sup>186</sup> Taking deposits is prohibited in non-branch bank business offices.<sup>187</sup> Under the BLMA, then, it is deposit activity, rather than loan activity, that must occur in a branch or main office.

The definition clarifies that “remote deposit capture facilities or

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178. § 53-43.7 (repealed 2012).

179. N.C. GEN. STAT. § 53C-6-1 (Supp. 2012).

180. N.C. GEN. STAT. § 53-1(1a) (repealed 2012).

181. N.C. GEN. STAT. § 53C-1-4(11) (Supp. 2012). The updated definition closes a major loophole under the Old Law and conforms more closely with definitions of “branch” under federal law.

182. *Id.* The federal definition of a branch is an office “at which deposits are received or checks paid or money lent. 12 U.S.C. § 1813(o) (2006).

183. § 53C-1-4(11).

184. N.C. GEN. STAT. § 53-1(3a) (repealed 2012).

185. § 53-1(3a) (repealed 2012).

186. N.C. GEN. STAT. § 53C-1-4(46) (Supp. 2012).

187. § 53C-6-18(d).

services” do not constitute “taking of deposits,” and that the services offered at non-branch bank business offices can “include loan production offices, mortgage loan offices, and insurance agency offices, or a combination thereof.”<sup>188</sup>

These changes eliminate obsolete laws with which banks generally were not in technical compliance. Under the Old Law: (1) the Commissioner’s decision to allow a branch closing required approval of the Commission;<sup>189</sup> (2) opening any “limited service facility” required the approval of the Commissioner, after public notice;<sup>190</sup> (3) changing the location of a limited service facility required the approval of the Commissioner;<sup>191</sup> and (4) a loan production office was a special kind of animal that required a special “agreement” with the Commissioner.<sup>192</sup> However, none of these requirements were being enforced.

The BLMA requires that a bank provide written notification to the Commissioner of its intent to establish<sup>193</sup> or to close<sup>194</sup> a non-branch bank business office. No time period or content is specified for notice about such an office that “will offer only products, services, or other activities already engaged in by the bank.”<sup>195</sup> However, beginning a new activity in a new non-branch bank business office requires advance notice with a description of the business to be conducted, and the Commissioner has 10 days from receipt of the notice to “decide whether to object” to the office.<sup>196</sup> The BLMA should have provided that the Commissioner could request more information and should have provided for appeal of a denial.

Out-of-state banks may open non-branch bank business offices in North Carolina with notice to the Commissioner,<sup>197</sup> and must give the Commissioner notice upon closing a non-branch bank business office.<sup>198</sup>

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188. § 53C-1-4(46).

189. N.C. GEN. STAT. § 53-62(f) (repealed 2012).

190. § 53-62(b); 04 N.C. ADMIN. CODE 03C .0201 (repealed 2012).

191. 04 N.C. ADMIN. CODE 03C .0301 (repealed 2012).

192. 04 N.C. ADMIN. CODE 03C .1702 (repealed 2012).

193. N.C. GEN. STAT. § 53C-6-18(a) (Supp. 2012).

194. § 53C-6-18(c).

195. § 53C-6-18(a)(2).

196. § 53C-6-18(a)(1).

197. § 53C-6-18(b).

198. § 53C-6-18(c).

C. *Branches*

The BLMA rules on branches resemble the Old Law's provisions on branches.<sup>199</sup> Banks still have the same basic rules: permission from the Commissioner after public notice to establish<sup>200</sup> or change the location of a branch,<sup>201</sup> and permission from the Commissioner after 90 days' notice to customers in order to close a branch.<sup>202</sup>

Interstate branching continues to be governed by Article 17B of Chapter 53.<sup>203</sup>

D. *Account Statements*

The BLMA requires statements for all deposit accounts, other than time deposits, to be rendered at least annually and upon the customer's reasonable request,<sup>204</sup> and authorizes electronic statements.<sup>205</sup> The Old Law, enacted in 1929, required banks to render statements of account and referred to vouchers and passbooks. It also provided that objections by the depositor had to be made within five years.<sup>206</sup> There was a risk that this statute might conflict with the more modern bank statement rule in the Uniform Commercial Code, which requires the customer to examine a statement with reasonable promptness and generally provides an outside limit of one year to claim unauthorized signature.<sup>207</sup>

The BLMA statement statute provides, in a manner similar to the Old Law,<sup>208</sup> that the time limit does not "relieve the depositor from the duty of exercising due diligence in the review of an account statement rendered by the bank and of timely notification to the bank upon discovery of any error."<sup>209</sup>

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199. N.C. GEN. STAT. § 53-62 (repealed 2012).

200. N.C. GEN. STAT. § 53C-6-15 (Supp. 2012).

201. § 53C-6-16.

202. § 53C-6-17.

203. § 53-224.9 *et seq.*

204. § 53C-6-12(a).

205. § 53C-6-12(b).

206. N.C. GEN. STAT. § 53-75 (repealed 2012).

207. N.C. GEN. STAT. § 25-4-406 (Supp. 2012).

208. N.C. GEN. STAT. § 53-76 (repealed 2012).

209. N.C. GEN. STAT. § 53C-6-12(c) (Supp. 2012).

*E. Bank Records*

The BLMA statute authorizes current bank records practices by providing that records may “be recorded, copied, or reproduced by any photographic, reproduction, electronic, or digital process or method . . . capable of accurately converting the records into tangible form within a reasonable time.”<sup>210</sup> Each tangible form of a record is itself a record,<sup>211</sup> and is admissible in evidence as a record “if otherwise admissible.”<sup>212</sup> Further, the certificate of an authorized person may authenticate bank records.<sup>213</sup>

Banks may destroy originals, subject to other laws and the rules and orders of the Commissioner requiring retention of the original for certain periods.<sup>214</sup> The Commission records rule has been updated to allude to the new BLMA statute, but the rule does not currently distinguish between an original and another tangible record.<sup>215</sup>

*F. Hours of Operation and Emergency Suspensions*

The BLMA provides, as under the Old Law,<sup>216</sup> that a bank’s board of directors determines the bank’s days, hours and holidays.<sup>217</sup> The BLMA also provides that the Commissioner may authorize a bank to close during an emergency<sup>218</sup> and that a bank officer may suspend any or all bank operations if the officer cannot communicate with the OCOB about the emergency.<sup>219</sup>

These provisions perpetuate this ambiguity: if the board of directors authorizes officers to close banks in emergencies, must the officer nevertheless obtain the Commissioner’s permission (assuming the officer is capable of communicating with the Commissioner)?

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210. § 53C-6-14(a). The statute also allows the Commissioner to approve other methods or recordkeeping by rule or order, but it is unclear what other methods might be approved.

211. *Id.*

212. § 53C-6-14(b).

213. § 53C-6-14(c).

214. § 53C-6-14(b).

215. 04 N.C. ADMIN. CODE 03C .0903.

216. N.C. GEN. STAT. § 53-77.1A (repealed 2012).

217. N.C. GEN. STAT. § 53C-6-19(a) (Supp. 2012).

218. N.C. GEN. STAT. § 53C-6-19(b) (Supp. 2012). The Old Law had similar provisions with more complicated wording. N.C. GEN. STAT. § 53-77.3(b) (repealed 2012).

219. N.C. GEN. STAT. § 53C-6-19(c) (Supp. 2012).

## VI. MERGERS AND OTHER COMBINATIONS

The BLMA regulates “combinations” involving North Carolina banks and their subsidiaries<sup>220</sup> and holding companies.<sup>221</sup> BLMA defines “combination” to include a statutory merger or share exchange, or the transfer of substantially all of a company’s assets and liabilities.<sup>222</sup>

Interstate bank mergers continue to be governed by Article 17<sup>223</sup> and Part 3 of Article 17B<sup>224</sup> of Chapter 53.

*A. Combinations involving Banks and their Subsidiaries*

Combinations involving North Carolina banks are governed by Article 7, Part 2 of Chapter 53C.<sup>225</sup> While the new statute probably does not represent a significant expansion of prior law as it was applied, the explicit scope of Article 7, Part 2 has been expanded.<sup>226</sup> For example, the BLMA now explicitly authorizes, and requires the Commissioner’s approval for, mergers of banks with non-depository institutions other than bank subsidiaries when a bank is the surviving entity.<sup>227</sup> The BLMA also regulates internal reorganizations involving banks and their subsidiaries more heavily.

1. Shareholder Approval

Perhaps the most significant change to the regulation of combinations under the BLMA is that the two-thirds supermajority shareholder approval requirement under the former Section 53-12(a) has been replaced with an absolute majority requirement<sup>228</sup> that aligns with

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220. See §§ 53C-7-201 to 53C-7-209.

221. See *Id.*

222. § 53C-1-4(17). This terminology is not consistent with the North Carolina Business Corporation Act. See §§ 55-11-01 to -10.

223. § 53-209 *et seq.*

224. § 53-224.17 *et seq.*

225. See §§ 53C-7-201 to -209.

226. See *id.*

227. § 53C-7-201 (2012).

228. See § 53C-4-1(b) (stating that the provisions contained in Chapter 55 of the General Statutes shall apply to banks, except where the provisions of Chapter 53C provide differently or where the Commissioner of Banks determines that any provision of Chapter 55 is inconsistent with the business of banking or the safety and soundness of banks).

the shareholder approval threshold applicable to business corporations under the North Carolina Business Corporation Act.<sup>229</sup> Bank holding companies were not subject to this requirement, so this change may remove some incentive for North Carolina banks to form, or maintain, bank holding companies. It also eliminates a longstanding quirk of North Carolina banking law, whereby a two-thirds supermajority shareholder vote was required for a bank merger, but not for a share exchange involving a bank.<sup>230</sup>

## 2. Applications

The BLMA replaces the Old Law's requirement for publication of legal notice during a period of four consecutive weeks<sup>231</sup> with a one-time publication requirement.<sup>232</sup> The new publication requirement is relatively forgiving in terms of timing, allowing publication within a window beginning 30 days prior to filing until up to 10 days after filing of the merger application.<sup>233</sup> Publication requirements associated with merger applications required by federal law are unaffected by the BLMA.<sup>234</sup>

The OCOB has confirmed that it will continue to accept the Interagency Bank Merger Act Application form for bank merger

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North Carolina's two-thirds supermajority shareholder vote requirement was not unique. For example, Delaware requires a two-thirds super-majority vote of each class of voting stock in order to merge a Delaware state bank with and into a national bank. *See* Delaware Code Ann. Title 5, § 782(a) (2012); *see also* Georgia O.C.G.A. 7-1-531(a)(2)(b) (2010) (requiring a two-thirds vote to merge a state bank under Georgia law). Other states, such as Ohio, require a two-thirds vote requirement unless the bank's charter provides for a lower threshold. *See* Ohio – Title XI 1115.11(A)(2) (2012). The National Bank Act also requires a two-thirds supermajority vote for a national bank merger, and imposes a two-thirds vote on the other bank participating in the merger even if it is not itself subject to that requirement. 12 U.S.C. § 215(a) (2006). The BLMA's approach is based on the premise that the corporate law applicable to banks should conform to that which applies to general business corporations to the maximum extent possible, consist with prudential regulation.

229. *See* § 55-11-03. *See also* RUSSELL M. ROBINSON, II, ROBINSON ON N.C. CORP. L. § 24.02[3] (7th ed. 2012).

230. *See* N.C. GEN. STAT. § 53-12(a) (repealed 2012).

231. *Id.*

232. *See* N.C. GEN. STAT. § 53C-7-202(b) (Supp. 2012).

233. *See id.*

234. *See* 12 U.S.C. § 1828(c)(3) (2006) (requiring publication of notice in a newspaper of general circulation in the community or communities in which the main office of each of the parties to the transaction is located).

applications.<sup>235</sup> The BLMA requires the Commissioner to assess “the character, competency, and experience of the proposed directors and executive officers of the surviving party of the combination” and to “determine whether the interests of the customers of and communities served by the parties to the combination would be adversely affected by the proposed combination.”<sup>236</sup> These requirements represent a codification of existing practice rather than an expansion of substantive law.

The BLMA requires the Commissioner to enter an order approving or denying an application within 60 days following the date that it was deemed substantially complete, except where “extraordinary circumstances require a longer period of review.”<sup>237</sup> The BLMA does not include any procedure for expedited processing of applications.

Although the BLMA provisions for change in control<sup>238</sup> and conversion<sup>239</sup> require the Commissioner to consider disclosures made in proxy solicitations or other documents in seeking votes, the merger provisions contain no such requirement.

A merger involving a North Carolina commercial bank requires the approval of the full North Carolina Banking Commission under the BLMA.<sup>240</sup> The BLMA does not provide on what specific grounds the Commissioner may deny a bank merger application not involving subsidiaries.<sup>241</sup> Denial of a bank merger application by the Commissioner can be appealed to the Commission,<sup>242</sup> and denial by the

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235. Interagency Bank Merger Act Application, FDIC, *available at* [www.fdic.gov/formsdocuments/bma-fapp.pdf](http://www.fdic.gov/formsdocuments/bma-fapp.pdf). See § 53C-7-201 (stating that an application filed under this part “shall be in the form required by the Commissioner and shall be accompanied by such fee as may be required by rule”). The Commission has not yet promulgated an administrative rule pursuant to this statute. The Commissioner’s staff has provided informal guidance on this point and the OCOB’s longstanding practice has been to utilize interagency applications wherever practicable.

236. §§ 53C-7-202(c), 207(c).

237. § 53C-7-203.

238. See *infra* Part VII and accompanying text. BLMA provisions on bank formation also do not require the Commissioner to consider disclosure to prospective investors.

239. See *id.*

240. 04 N.C. ADMIN. CODE 03C .0405 (following a public hearing, the North Carolina Banking Commission will issue a final order approving or disapproving the proposed combination). This administrative rule, which existed under the Old Law, was amended to recite list its authority under § 53C-7-203.

241. N.C. GEN. STAT. § 53C-7-203 (Supp. 2012).

242. § 53C-7-209.

Commission can be appealed to the Wake County Superior Court.<sup>243</sup>

### 3. Bank Mergers into Federal Charters

The BLMA defines a “federally chartered institution” as a national bank or federal savings association.<sup>244</sup> The BLMA provides that if a bank merges with a federally chartered institution and the federally chartered institution survives, the chartering authority of the federally chartered institution shall review the transaction in accordance with applicable laws of the United States.<sup>245</sup>

### 4. Interim Banks

The BLMA sets forth explicit statutory authority for the formation of an interim bank.<sup>246</sup> Interim banks have a variety of uses, especially in the context of mergers and acquisitions. They are particularly useful in connection with certain types of purchase and assumption transactions, including FDIC failed bank acquisitions.<sup>247</sup> A separate application for FDIC deposit insurance is required if an interim bank is assuming insured deposits in any transaction.<sup>248</sup>

### 5. Bank Mergers – Effect on Corporate Fiduciaries

Although North Carolina corporate law governs the general effect of mergers, the BLMA brings forward a provision similar to one in the Old Law<sup>249</sup> making clear that “fiduciary rights, powers, duties,

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243. § 53C-2-6.

244. § 53C-1-4(37).

245. § 53C-7-206.

246. See § 53C-7-204. The Office of the Comptroller of the Currency has long provided an application process for interim charters. 12 C.F.R. 5.33(e)(4) (2012). Several states authorize the chartering of interim institutions. See, e.g., 5 DEL. ADMIN. CODE § 102 (2012) (stating the Delaware banking regulations).

247. See FDIC RESOLUTIONS HANDBOOK at 19, available at <http://www.fdic.gov/bank/historical/reshandbook/ch3pas.pdf> (stating that, “[h]istorically, the Federal Deposit Insurance Corporation (FDIC) has used three basic resolution methods: purchase and assumption (P&A) transactions, deposit payoffs, and open bank assistance (OBA) transactions. Of the three, purchase and assumption transactions are the most common.”).

248. See Interagency Bank Merger Act Application, FDIC, available at [www.fdic.gov/formsdocuments/bma-fapp.pdf](http://www.fdic.gov/formsdocuments/bma-fapp.pdf).

249. N.C. GEN. STAT. § 53-17 (repealed 2012).



and liabilities” continue in a successor corporate fiduciary which combines with or acquires the assets and liabilities of another corporate fiduciary.<sup>250</sup>

## 6. Mergers involving Bank Subsidiaries

The BLMA requires applications for most mergers involving bank subsidiaries.<sup>251</sup> The BLMA explicitly requires approval for a bank to merge a subsidiary into itself,<sup>252</sup> merge a subsidiary with another company,<sup>253</sup> or combine subsidiaries of different banks owned by the same holding company.<sup>254</sup>

The BLMA does not require an application for merger of a bank subsidiary if (i) the merger counterparty is neither a bank nor a subsidiary of a bank and (ii) the subsidiary will not be the survivor of the merger.<sup>255</sup> Also, the BLMA requires no application for the merger of two subsidiaries of the same bank.<sup>256</sup> Applications to one or more federal regulators may still be required, however.

It appears Commission approval is not required for bank mergers involving subsidiaries.<sup>257</sup> The BLMA does not specify a time period for OCOB’s processing of applications for mergers of subsidiaries. The Commissioner may set fees for subsidiary merger applications by rule,<sup>258</sup> which may be different from the fee for a bank merger application not involving subsidiaries.<sup>259</sup> The BLMA provides

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250. N.C. GEN. STAT. § 53C-7-205 (Supp. 2012). Because of inadvertence, the BLMA contains a similar but slightly less detailed provision in § 53C-7-208. The Clarifications Bill may address this duplication.

251. § 53C-7-207(a).

252. § 53C-7-207(a)(1).

253. § 53C-7-207(a)(2).

254. § 53C-7-207(a)(3).

255. *See* § 53C-7-207(a).

256. *See id.* This provision was a fairly late addition made in drafting the BLMA. As mergers between wholly-owned subsidiaries of the same bank are very unlikely to increase the risk profile of the bank or present other supervisory concerns, it is a logical addition. Merger of subsidiaries of different banks owned by the same holding company do require approval.

257. 04 N.C. ADMIN. CODE 03C .0405, which existed under the Old Law provides for banking commission review of bank mergers, was amended to recite list its authority under § 53C-7-203, the BLMA statute which governs bank mergers not involving subsidiaries, but not § 53C-7-207, the BLMA statute which governs bank mergers that do involve subsidiaries).

258. § 53C-7-207(c).

259. *See supra* note 235 and accompanying text.

that the Commissioner may deny an application for a subsidiary merger if the transaction “would present . . . risks to the safe and sound operation of the bank deemed unacceptable to the Commissioner.”<sup>260</sup> Otherwise the procedure described above for mergers not involving subsidiaries appears to apply to these mergers.

## 7. Effect of Changes

The new requirements for approval of those mergers (a) in which a bank merges a non-depository institution into itself, and (b) which involve subsidiary mergers, create an anomaly for acquisitive banks. Specifically, if the bank effects the acquisition by merger, an application is required. If the acquisition is structured as a stock purchase, however, it only requires a notice under the Investment Statute, which in many cases may be an after-the-fact notice for a well-capitalized and well-managed bank.<sup>261</sup>

The Old Law did not regulate these mergers comprehensively, but did provide explicitly that a bank could merge a subsidiary into itself, apparently with no approval requirement.<sup>262</sup>

### *B. Mergers of Bank Holding Companies*

The Old Law did not require approval of bank holding company mergers, although such mergers often involved bank mergers that did require approval. Under the BLMA, a bank holding company may combine with one or more other bank holding companies or other non-holding companies, with the approval of the Commissioner of Banks.<sup>263</sup>

The OCOB has confirmed that it will accept the form of application specified by the Federal Reserve Board of Governors for bank holding company merger applications under federal law.<sup>264</sup> The notice requirement for holding company merger applications is a one-

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260. § 53C-7-207(c).

261. § 53C-5-2.

262. N.C. GEN. STAT. § 53-12(b) (repealed 2012).

263. See N.C. GEN. STAT. § 53C-10-201 (Supp. 2012).

264. See *id.* (stating an application filed under this part “shall be in the form required by the Commissioner and shall be accompanied by such fee as may be required by rule”). The Commission has not yet promulgated an administrative rule pursuant to this statute. The Commissioner’s staff has provided informal guidance on this point and the OCOB’s longstanding practice has been to utilize interagency applications wherever practicable.

time publication no more than thirty days before or ten days after the filing of the application.<sup>265</sup> The BLMA requires the Commissioner to “examine the proposed combination, including the character, competency, and experience of the proposed directors and executive officers of the surviving party of the combination, to determine whether the interests of the customers and communities served by the banks controlled by the parties to the combination would be adversely affected by the proposed combination.”<sup>266</sup>

The BLMA requires that the Commissioner to enter an order approving or denying an application within sixty days following the date that it was deemed to be substantially complete, except where “extraordinary circumstances require a longer period of review.”<sup>267</sup> Bank holding company mergers do not require approval of the Commission.<sup>268</sup> Denial of a bank merger application by the Commissioner can be appealed to the Commission,<sup>269</sup> and denial by the Commission can be appealed to the Wake County Superior Court.<sup>270</sup>

## VII. CHANGE OF CONTROL PROVISIONS

### A. *Change in Bank Control*

The BLMA regulates “control transactions,” defined as “[t]he acquisition of control over a bank or a bank holding company other than pursuant to a combination.”<sup>271</sup> Changes in control of a bank are governed by Part 1 of Article 7,<sup>272</sup> and changes in control of a bank holding company are governed by similar provisions Part 1 of Article

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265. See § 53C-10-202(b). The existing notice requirements for applications filed pursuant to the Bank Holding Company Act of 1956 and Federal Reserve Board of Governors Regulation Y are unaffected by Chapter 53C of the North Carolina General Statutes.

266. See § 53C-10-202(c).

267. § 53C-10-203.

268. *Id.* See *supra* notes 257–260 and accompanying text for discussion of the Commission approval requirement for bank mergers.

269. § 53C-10-206.

270. § 53C-2-6.

271. § 53C-1-4(22).

272. § 53C-7-101 *et seq.* The numbering sequence in Article 7 was changed because it is divided into parts. The federal law governs changes of control of banks and bank holding companies in one statutory provision and one implementing regulation. 12 U.S.C. § 1817(j)(13) (2006); 12 C.F.R. pt. 225 (2012).

10, of Chapter 53C.<sup>273</sup> “Control” is defined as:

The possession, directly or indirectly, of the power or right to direct or to cause the direction of the management or policies of a person by reason of an agreement, understanding, proxy, or power of attorney or through the ownership of or voting power over ten percent or more of the voting securities of the person.<sup>274</sup>

The grammatically correct and more logical reading of this definition is that ten percent ownership is not, in and of itself, control. If one purchased thirteen percent of a bank’s stock, but eighty-five percent were controlled by another person, one would not have acquired the ability to “to cause the direction of the management or policies of” the bank. Also, unlike the change of control provisions under federal law,<sup>275</sup> the BLMA does not define control with reference to a percentage of any class of voting securities, but of all “the voting securities.”<sup>276</sup> If one owned a large percentage of one class of securities entitled to one vote per share, one might not have control if another class had 10 votes per share.

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273. § 53C-10-102 *et seq.* The numbering sequence in Article 10 was changed because it is divided into parts. The federal law governs changes of control of banks and bank holding companies in one statutory provision and one implementing regulation. 12 U.S.C. § 1817(j)(13); 12 C.F.R., pt. 225

274. § 53C-1-4(21). Under federal law, control exists if one has either “the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 per centum or more of any class of voting securities of an insured depository institution.” 12 U.S.C. § 1817(j)(8)(B). So, the possession of 25% or more of any class of voting security is control in and of itself. The implementing regulations create a rebuttable presumption that ownership of 10% or more of any class of voting securities creates control if either (a) the stock is registered under the Securities Exchange Act of 1934, or (b) no other person will hold the power to vote a greater percentage of that class. 12 C.F.R. § 225.41(c)(2). A key distinction, therefore, between the North Carolina statute and the federal framework is the application of a bright line statutory threshold.

The 10% threshold in § 53C-1-4(21) does, however, align with the federal Change in Bank Control Act of 1978, which presumes that a company controls a bank if it owns, controls, or holds the power to vote 10% or more of any class of voting securities of the institution (and the institution has registered securities or no other person owns or controls a greater percentage of the same class of voting securities). *See* 12 C.F.R. § 225.41(c)(2); *see also* 12 U.S.C. § 1817(j).

275. *See* N.C. GEN. STAT. § 53C-4-2(d) (Supp. 2012).

276. The Clarifications Bill may address this difference from the federal control definition. The BLMA defines a “voting security” as a “security that (i) confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the company or (ii) is convertible into, or entitles the holder to receive upon its exercise, a security that confers such a right to vote.” § 53C-1-4(74). For purposes of this statute, preferred stock issued to the United States Treasury under the Capital Purchase Program or the Small Business Lending Program would not be classified as voting securities.

Subject to certain exceptions discussed below, control transactions require the prior approval of the Commissioner.<sup>277</sup> A person may contract to engage in a control transaction subject to the required approval.<sup>278</sup> As a practical matter, even if one believes that control will not be acquired in a given transaction, it is advisable for a party wishing to acquire ten percent or more of any class of voting securities of a bank or bank holding company to consult with OCOB prior to consummation of the acquisition in order to confirm that the Commissioner is in agreement.

### *B. Applications*

The BLMA requires a person seeking approval of a control transaction to file an application in the form required by the Commissioner, provide other information the Commissioner requests, and pay any filing fee required by rule.<sup>279</sup> If the applicant is a group of persons, the Commissioner may require each person to submit “information relevant to the application,”<sup>280</sup> but information “about the character, competence, or experience of an acquiring person or its proposed management personnel or affiliates” is confidential.<sup>281</sup> The applicant must publish a one-time notice of the application not more than 30 days before and not more than 10 days after filing the application, which gives the Commissioner’s address and notes that comments received by the Commissioner within 14 days of the date of publication will be considered.<sup>282</sup>

The BLMA requires the Commissioner to assess the “character, competence, and experience of the acquiring person and its proposed management personnel” and “whether the interests of the customers and communities severed by the bank would be adversely affected.”<sup>283</sup> The

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277. § 53C-7-101 (banks); § 53C-10-102 (bank holding companies).

278. *Id.*

279. § 53C-7-102(a) (banks); § 53C-10-103(a) (bank holding companies). No fees have been established by rule as of this writing in early 2013.

280. § 53C-7-102(b) (banks); § 53C-10-103(b) (bank holding companies).

281. § 53C-7-102(c) (banks); § 53C-10-103(c) (bank holding companies). The provision for banks has an incorrect cross reference, which the Clarifications Bill may address.

282. § 53C-7-103 (banks); § 53C-10-104 (bank holding companies). The medium of publication is not described.

283. § 53C-7-104(a) (banks); *see also* § 53C-10-105(a) (bank holding companies) (“The Commissioner shall examine the proposed control transaction, including the character,

grounds for denial of an application effectively adds several other factors for consideration, including financial stability and the plans of the persons seeking control.<sup>284</sup>

The BLMA also provides that, if any proxies are solicited in connection with the control transaction, the Commissioner may deny the application for lack of adequate and complete disclosures about material information, or lack of a “a prominent statement that neither the control transaction nor any solicitation of such holders’ votes or consents has been approved by the Commissioner and that any representation to the contrary is a criminal offense.”<sup>285</sup> It is unclear to what extent the Commissioner will require applicants to file preliminary or definitive proxy solicitation materials for review in connection with control transactions.<sup>286</sup>

The BLMA generally gives the Commissioner 60 days from the date a completed application is received to act on it, although the statute permits additional time in extraordinary circumstances.<sup>287</sup> The Commissioner may deny a control transaction application if it is incomplete,<sup>288</sup> or based on concerns about the financial condition or management of the applicant.<sup>289</sup>

The BLMA provides that conditions to approvals shall be enforceable against anyone receiving the approval.<sup>290</sup> The Commissioner’s denial of a control transaction application may be appealed to the Commission.<sup>291</sup>

### C. *Exceptions to Prior Approval Requirement*

The BLMA sets out somewhat different exceptions to the prior

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competence, and experience of the acquiring person and its proposed management personnel, to determine whether the financial stability of the holding company or the interest of the customers served by one or more bank subsidiaries of the holding company would be adversely affected by the proposed control transaction.”).

284. § 53C-7-104(b) (banks); 53C-10-105(b) (bank holding companies).

285. § 53C-7-104(b)(6) (banks); § 53C-10-105(b)(6) (bank holding companies).

286. The BLMA contains a similar provision for conversions. *See infra* Part VIII.B. The BLMA does not include such a provision for bank formations or for combinations involving banks.

287. § 53C-7-104(a) (banks); § 53C-10-105(a) (bank holding companies).

288. § 53C-7-104(b)(5) (banks); § 53C-10-105(b)(5) (bank holding companies).

289. § 53C-7-104(b)(1)–(4) (banks); § 53C-10-105(b)(1)–(4) (bank holding companies).

290. § 53C-7-104(c) (banks); § 53C-10-105(c) (bank holding companies).

291. § 53C-7-105 (banks); § 53C-10-106 (bank holding companies).

approval requirement for banks and bank holding companies. Many of these exceptions are conditioned on providing after-the-fact notices at least 10 days before the acquirer votes the securities. Some exemptions from the federal Change in Bank Control Act require after-the-fact notices within 90 days of a transaction, but they do not limit voting the securities.<sup>292</sup>

The following exceptions are available for both bank and bank holding company acquisitions: (a) acquisition of additional voting securities pursuant to an order in a prior control transaction approval allowing the further acquisition, subject to the after-the-fact notice requirements before voting;<sup>293</sup> (b) acquisition of additional voting securities by operation of law, will, or intestate succession, subject to after-the-fact notice requirements before voting;<sup>294</sup> bona fide gifts;<sup>295</sup> and (c) any transaction exempted by the Commissioner “because approval of such a transaction is not necessary to achieve the objectives of this Chapter.”<sup>296</sup>

An exception for the following transactions exempt under Section 3 of the federal Bank Holding Company Act is available only to

292. *See, e.g.*, 12 C.F.R. §§ 225.42(b) (2012) (bank holding companies), 303.83(b) (state nonmember banks).

293. §§ 53C-7-101(c)(2) (banks), 53C-10-102(c)(1) (bank holding companies). The Old Law had no such exception. N.C. GEN. STAT. § 53-42.1 (repealed 2012). Regulations implementing the federal Change in Bank Control Act exempt further acquisitions of voting securities by persons who already have control without the prior order requirement and without an after-the-fact notice requirements. *See, e.g.*, 12 C.F.R. § 225.42(a)(2) (2012) (exempting acquisition of additional voting securities of bank holding company by one who already lawfully acquired control, unless otherwise provided in the approval of the prior control); 12 C.F.R. § 303.83(a)(2) (2012) (exempting acquisition of additional voting securities of state nonmember insured bank by one who already lawfully acquired control).

294. N.C. GEN. STAT. § 53C-7-101(c)(3) (Supp. 2012) (banks); § 53C-10-102(c)(2) (bank holding companies). The Old Law exempted shares acquired by will or intestate succession. N.C. GEN. STAT. § 53-42.1(a)(3)(d)) (repealed 2012). Regulations implementing the federal Change in Bank Control Act exempt shares acquired “through inheritance.” *See, e.g.*, 12 C.F.R. § 225.42(b)(i) (2012) (bank holding companies); § 303.83(b)(1)(i) (state nonmember banks).

295. N.C. GEN. STAT. § 53C-7-101(c)(4) (Supp. 2012) (banks); § 53C-10-102(c)(3) (bank holding companies). The Old Law exempted gifts not “made for the purpose of circumventing this section.” N.C. GEN. STAT. § 53-42.1(a)(3)(e) (repealed 2012). Regulations implementing the federal Change in Bank Control Act also exempt “bona fide gifts.” *See, e.g.*, 12 C.F.R. §§ 225.42(b)(1)(ii) (2012) (bank holding companies); § 303.83(b)(1)(ii) (state nonmember banks).

296. N.C. GEN. STAT. § 53C-7-101(c)(5) (Supp. 2012) (banks); *see also* § 53C-10-102(c)(4) (bank holding companies) (“[B]ecause approval of the transaction is not necessary to achieve the objectives of this Chapter.”). The Old Law did not grant the Commissioner similar discretionary authority. N.C. GEN. STAT. § 53-42.1 (repealed 2012).

bank holding companies;<sup>297</sup> (a) voting securities acquired in good faith in a fiduciary capacity, provided the trust is not deemed to be a “company” for purposes of the Bank Holding Company Act;<sup>298</sup> (b) voting securities acquired in the regular course of securing or collecting on debt;<sup>299</sup> (c) additional voting securities acquired by a person who already has majority ownership;<sup>300</sup> and (d) bank holding company formations in which bank interests are exchanged for the same interest in a holding company.<sup>301</sup> The BLMA arguably should have extended these exemptions to banks.

The BLMA provides that banks have an exception for debts previously contracted “in good faith and not for the purpose of acquiring control of the bank,” subject to after-the-fact notice requirements before voting.<sup>302</sup> The similar exception for bank holding companies noted above is not subject to a prior notice requirement.<sup>303</sup> Also, an exception for transactions subject to approval under section 3 of the federal Bank Holding Company Act<sup>304</sup> is available only to

297. N.C. GEN. STAT. § 53C-10-102(c)(5) (Supp. 2012). The statutory reference to the Bank Holding Company Act refers to 12 U.S.C. § 1842 (2006), but probably should be clarified to refer to subsection (a) of that statute.

298. 12 U.S.C. § 1842(a)(5)(A)(i) (2006); *see also* 12 C.F.R. § 225.2 (2012). A trust generally will be deemed not to be a “company” for purposes of the Bank Holding Company Act if the trust:

- (i) Terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effective date of the trust or within 25 years;
- (ii) Is a testamentary or *inter vivos* trust established by an individual or individuals for the benefit of natural persons (or trusts for the benefit of natural persons) who are related by blood, marriage or adoption;
- (iii) Contains only assets previously owned by the individual or individuals who established the trust;
- (iv) Is not a Massachusetts business trust or Delaware statutory trust; and
- (v) Does not issue shares, certificates, or any other evidence of ownership.

299. 12 U.S.C. § 1842(a)(5)(A)(ii) (2006).

300. § 1842(a)(5)(B).

301. § 1842(a)(5)(C).

302. N.C. GEN. STAT. § 53C-7-101(c)(1) (Supp. 2012). The Old Law required an after-the-fact notices when shares were acquired in connection with debts previously contracted, but did not limit voting of those shares. N.C. GEN. STAT. § 53-42.1(a)(3)(e) (repealed 2012). The federal debts previously contracted exceptions also require after-the-fact notice, but do not limit voting. *See, e.g.*, 12 C.F.R. §§ 225.42(b)(iii) (bank holding companies), § 303.82(b)(iii) (state nonmember banks).

303. *See supra* Part IV.E.

304. 12 U.S.C. § 1841 *et seq.* (2006).



banks.<sup>305</sup> Under the BLMA as enacted, therefore, it appears that (a) a transaction in which a bank holding company acquires an additional bank is exempt from a change of control transaction because it is subject to review by the Federal Reserve Board,<sup>306</sup> but (b) acquisition of control of a bank holding company, which is subject to review by the Federal Reserve Board under the federal Change in Bank Control Act,<sup>307</sup> also must be approved by the Commissioner. As enacted, the BLMA does not provide banks with an exception for voting securities acquired in good faith in a fiduciary capacity equivalent to the exception contained in Section 3 of the Bank Holding Company Act.<sup>308</sup>

The BLMA gives the Commissioner ten days after receipt of a notice to object or to request further information.<sup>309</sup> An acquiring person who receives a notice of objection is required to submit an application.<sup>310</sup> If an application for a control transaction is required and voting securities are acquired prior to approval, then the securities may not be voted by the acquiring person and the shares “shall be deemed authorized but unissued” for purposes of quorum determinations.<sup>311</sup> When an after-the-fact notice is required, the same provisions apply “until . . . the Commissioner has not issued an objection to the notice and any requirement of the Commissioner for the filing of further information has been determined by the Commissioner to have been satisfied.”<sup>312</sup>

The BLMA authorizes the Commissioner to require a person who is obligated to file any change of control notice or application to appoint an agent resident in North Carolina for service of process.<sup>313</sup>

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305. N.C. GEN. STAT. § 53C-7-101(c)(6) (Supp. 2012).

306. 12 U.S.C. § 1842(a)(2) (2006).

307. § 1817(j).

308. Compare § 1842(a)(5)(A)(i) (containing a good faith fiduciary capacity exception), with N.C. GEN. STAT. § 53C-7-101(c) (Supp. 2012) (no such exception). That exception also was not included in the Old Law. N.C. GEN. STAT. § 53-42.1. (repealed 2012). Although the federal Bank Holding Company Act provides this exemption for treatment as a bank holding company, the federal Change in Bank Control Act does not provide a fiduciary exemption for change of control of a bank or bank holding company.

309. N.C. GEN. STAT. § 53C-7-101(d) (Supp. 2012) (banks), § 53C-10-102(d) (bank holding companies).

310. § 53C-7-101(d) (banks); § 53C-10-102(d) (bank holding companies).

311. § 53C-7-101(e) (banks); § 53C-10-102(e) (bank holding companies).

312. § 53C-7-101(e)(3) (banks); § 53C-10-102(e)(3) (bank holding companies).

313. See § 53C-7-101(b) (banks); see also § 53C-10-102(b) (bank holding companies).

D. *Other Matters*

Article 10 of Chapter 53C also contains provisions relating more generally to the registration and regulation of bank holding companies.<sup>314</sup> Specifically, the BLMA requires a bank to notify the Commissioner of “any changes in its directors, president, chief executive officer, chief financial officer, chief loan officer, or chief credit officer by the close of the second day on which the [bank] is open for business following such change.”<sup>315</sup> A bank holding company is required to report “to the Commissioner any changes in its directors, president, chief executive officer, or chief financial officer by the close of the second day on which the holding company is open for business following such change.”<sup>316</sup> The Old Law placed a similar requirement in the change in control provision.<sup>317</sup>

The BLMA does not bring forward a provision of the Old Law requiring reports to the Commissioner within 24 hours of certain loans secured by ten percent or more of a bank’s voting securities.

### VIII. BANK FORMATIONS AND CHARTER CONVERSIONS

A. *De Novo Bank Formation*

The organization of *de novo* commercial banks under North Carolina law is now governed by Article 3 of Chapter 53C. North Carolina saw a robust period of *de novo* bank activity from 2004 through 2008,<sup>318</sup> but the North Carolina Banking Commission has not chartered a *de novo* bank since April 2009.<sup>319</sup> The BLMA implements many necessary refinements to the Old Law’s *de novo* process<sup>320</sup> that

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314. These provisions are arguably misplaced in the statute. The Clarifications Bill may relocate these provisions and combine them with legacy provisions of the Old Law which remain in Article 18 of Chapter 53.

315. N.C. GEN. STAT. § 53C-7-101(a) (Supp. 2012). The statute incorrectly refers to “holding company” and this two day requirement is not prominently or logically placed. The Clarifications Bill may address these concerns.

316. § 53C-10-302.

317. N.C. GEN. STAT. § 53-42.1(d) (repealed 2012).

318. Over 20 *de novo* North Carolina commercial banks were chartered during this period. See *NC State Charter Banks and Trust Companies*, N.C. COMM’R OF BANKS, <https://www.nccob.org/Online/brrts/banksandtrusts.aspx> (last visited Jan. 21, 2013).

319. See *id.*

320. See N.C. GEN. STAT. § 53-17.2.

will be useful when new state banks are again being chartered.

### 1. Application Process

The BLMA requires banks to be organized as corporations under North Carolina law.<sup>321</sup> Pursuant to Section 53C-3-2(b), a proposed bank's articles of incorporation may be filed with the North Carolina Secretary of State much earlier in the organizational process than under the Old Law.<sup>322</sup> This step, however, only establishes the proposed bank's corporate shell. The proposed bank may not commence its banking business until a bank charter has been issued<sup>323</sup> and FDIC deposit insurance is in effect.<sup>324</sup> Thus, the "chartering" of the entity is distinct from its corporate "organization,"<sup>325</sup> and occurs near the end of the *de novo* process.

The benefit of this change is that it allows the proposed bank's body corporate to enter into contracts and commence operations directly related to the bank's organization, without the need to form a separate organizational vehicle.<sup>326</sup> A bank that has been incorporated, but which remains in organization and has not yet been chartered, may only transact business that is incidental and necessary to its organization or the application for a charter or preparation for commencing the business

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321. N.C. GEN. STAT. § 53C-4-1(a) (Supp. 2012). The IRS has long prohibited the organization of banks as limited liability companies. See T. Scott Kummer *Should the IRS Continue to Deny Banks the Benefits of the LLC Structure?*, 8 N.C. BANKING INST. 325 (2004). Banks, including North Carolina chartered commercial banks, may however be organized as S corporations under subchapter S of the Internal Revenue Code of 1986. See Michael Duane Jones, *S Banks: Should Banks Covert to S Corporations?*, 4 N.C. BANKING INST. 627 (2000).

322. Compare N.C. GEN. STAT. § 53C-3-2(a)-(b) (Supp. 2012), with N.C. GEN. STAT. §§ 53-3 to -5 (repealed 2012) (technically requiring that a proposed bank's articles of organization not be filed with the Secretary of State until after the Commissioner had made numerous findings of fact concerning the merits of the application). A similar provision applies to North Carolina trust companies. See N.C. GEN. STAT. § 53-333 (2011).

323. See N.C. GEN. STAT. § 53C-3-2(c) (Supp. 2012).

324. See § 53C-3-7(a)(3). Chapter 53, as originally enacted, did not require the activation of FDIC deposit insurance as a pre-condition to chartering a bank, because Chapter 53 predated the existence of the FDIC. Chapter 53 was amended in 1989 to add this requirement. See N.C. GEN. STAT. § 53-9.1(a) (repealed 2012).

325. See N.C. GEN. STAT. § 53C-3-2 (Supp. 2012).

326. Limited liability companies were commonly used as organizational entities during the organization of *de novo* banks under the Old Law, although limited partnerships, and business corporations typically electing subchapter S status, were also suitable organizational entities.

of banking.<sup>327</sup>

Although the BLMA permits incorporation of a bank much earlier in the organizational process, there still exists substantial uncertainty as to when the entity becomes a “bank” for purposes of the exemptions from securities registration available to banks under Section 3(a)(2) of the Securities Act of 1933<sup>328</sup> and Section 78A-16(3) of the North Carolina Securities Act.<sup>329</sup> The conservative approach would be to assume that a bank in organization may not be a “bank” for purposes of applicable securities laws until it has been “chartered” and has received an FDIC order activating deposit insurance. The Securities and Exchange Commission’s position is that the exemption for securities offered by banks may not be available unless subscription funds are held in escrow until the bank is authorized to open for business.<sup>330</sup>

The BLMA requires the organizers of a proposed bank to publish notice of the application one time, at least 30 days before the Commission’s public hearing on the application.<sup>331</sup> Under the Old Law, the OCOB published notice of charter applications.<sup>332</sup>

The statutory factors to be considered by the Commissioner in connection with a *de novo* application<sup>333</sup> have been expanded from those delineated in Section 53-4 of the Old Law.<sup>334</sup> This change codifies the prior scope of review. Although the BLMA provisions for

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327. See § 53C-3-2(c)(1). This language aligns almost precisely with the requirement under prior law that a banking corporation in organization not transact any business, “except such as is incidental and necessarily preliminary to its organization until it has been authorized to do so by the Commissioner of Banks.” N.C. GEN. STAT. § 53-9 (repealed 2012).

328. See 15 U.S.C. § 77c(a)(2) (2006) (exempting any security issued or guaranteed by a bank from registration under the Securities Act of 1933, as amended).

329. N.C. GEN. STAT. § 78A-16(3) (Supp. 2012).

330. See, e.g., Bank of World No Action Letter, [1983-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,503 (June 6, 1983). The federal exemption defines “bank” to include a “banking institution” whose business “is substantially confined to banking” and which is “supervised” by a state banking regulator. See 15 U.S.C. § 77c(a)(2) (2006). The BLMA provides that any “bank” is a “banking institution” for purposes of the Securities Act of 1933. See N.C. GEN. STAT. § 53C-1-4(47) (Supp. 2012). The BLMA also provides that a bank is “engaged in the business” of banking. § 53C-1-4(4). See *infra* Part VIII.A.2 (discussing BLMA’s escrow requirements in bank formation offerings).

331. See § 53C-3-5(a).

332. See N.C. GEN. STAT. § 53-2-4 (repealed 2012).

333. See § 53C-3-4 (Supp. 2012); see also N.C. GEN. STAT. § 53-4 (repealed 2012).

334. N.C. GEN. STAT. § 53-4. (repealed 2012).

change in control<sup>335</sup> and conversion<sup>336</sup> require the Commissioner to consider the accuracy of disclosures in proxy solicitation materials, the bank formation provisions do not require the Commissioner to review the disclosure furnished to prospective investors in a *de novo* bank.

If the Commissioner approves a *de novo* charter application, it must then be approved by the Commission.<sup>337</sup> The Commission's review is limited to determining whether the statutory criteria were satisfied and the chartering provisions followed.<sup>338</sup> Applicants may appeal the denial of an application by the Commissioner<sup>339</sup> or the Commission.<sup>340</sup>

As was the case under the Old Law,<sup>341</sup> the BLMA continues to require that a *de novo* applicant that has received charter approval commence business within six months of the date of such approval, unless such period is otherwise extended by the Commissioner.<sup>342</sup>

## 2. Capitalization

The Old Law required that the payment of stock in a *de novo* bank be "in cash."<sup>343</sup> The BLMA requires that the consideration for the issuance of capital stock in a commercial bank consist of "United States currency."<sup>344</sup> This may be a distinction that does not amount to a difference. The key effect of this requirement is that "sweat equity," founders' shares, and stock issued in consideration for services rendered are still not permissible under North Carolina law in the organization of a commercial bank.<sup>345</sup> The BLMA does not, however, limit a bank's

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335. BLMA provisions on bank mergers also do not require the Commissioner to consider disclosure to equity holders. *See infra* Part VIII.A.1.

336. *Id.*

337. *See* N.C. GEN. STAT. § 53C-3-6 (Supp. 2012) (stating that the Banking Commission may adopt the Commissioner's recommendation with respect to conditions for issuance of a charter, or it may modify the conditions recommended by the Commissioner).

338. *See id.*

339. *See* § 53C-3-4(d). *See infra* Part IX.C (describing the procedure for appeal of agency actions pursuant to N.C. GEN. STAT. §§ 53C-2-6. and 150B-51).

340. *See* N.C. GEN. STAT. § 53-3-6(b) (repealed 2012). *See infra* Part IX.C.

341. *See* § 53-5 (repealed 2012).

342. *See* N.C. GEN. STAT. § 53C-3-7(c) (Supp. 2012).

343. N.C. GEN. STAT. § 53-6 (repealed 2012).

344. *See* N.C. GEN. STAT. § 53C-3-7(a)(1) (Supp. 2012).

345. *See id.* The reason for this policy is straightforward: "sweat equity" has little or no utility when it comes to absorbing losses. *See supra* Part IV.F.1 for a discussion regarding the permissibility of equity-based compensation following the initial organization of a

issuance of restricted stock or other equity compensation after its formation.<sup>346</sup>

The BLMA requires that subscription funds paid for shares of the proposed bank's capital stock, and dividends and interest on those funds, be held in escrow, under an escrow agreement satisfactory to the Commissioner, until the Commissioner of Banks issues a charter to the proposed bank<sup>347</sup> or otherwise approves disbursement from escrow.<sup>348</sup>

### 3. Articles of Incorporation

The requirements for a commercial bank's articles of incorporation under the BLMA are identical to those required under North Carolina's general corporate law,<sup>349</sup> together with "[a]ny provision the Commissioner requires or authorizes as a substitute for a provision that otherwise would be required" under general corporate law.<sup>350</sup> The BLMA has eliminated the archaic requirement that a bank's articles of incorporation list the names of all subscribers for stock, with their address and number of shares subscribed by each.<sup>351</sup> An amended Commission rule requires special limiting language in charter provisions eliminating director liability.<sup>352</sup>

#### B. Charter Conversions

Article 7, Part 3 of the BLMA provides for the conversion of other depository institutions to a North Carolina bank charter and vice

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commercial bank.

346. See *supra* Part III.A.7.

347. See § 53C-3-2(c).

348. See § 53C-3-2(c)(3) (authorizing disbursement of escrowed subscription funds upon approval of the Commissioner of Banks, in order to refund funds to subscribers, or as otherwise required by law).

349. See N.C. GEN. STAT. § 55-2-02 (2011) (setting forth the requirements for articles of incorporation filed pursuant to the North Carolina Business Corporation Act).

350. See N.C. GEN. STAT. § 53C-3-3(a)(2) (Supp. 2012).

351. See N.C. GEN. STAT. § 53-2(5) (repealed 2012). With articles of incorporation readily available online, the requirement under former § 53-2(5) presented legitimate privacy concerns.

The tradition of listing all subscribers' names in the chartering document might be viewed as antiquated, given that it dated as far back as the original charter establishing the Bank of England in 1694. See Bank of England Act 1694, §§ 19, 26-27 (providing statutory authority for the chartering of the Bank of England by William and Mary on July 27, 1694).

352. See *supra* Part II.C.

versa.<sup>353</sup> It does not, however, change the long-standing supervisory expectations that a converting depository institution possess a satisfactory composite safety and soundness rating, Community Reinvestment Act rating, and compliance examination rating. It is critical that these provisions be read in conjunction with Section 612 of the Dodd-Frank Act, which was implemented to discourage regulatory arbitrage.<sup>354</sup>

### 1. Conversion to Bank

An application for conversion to a North Carolina bank charter must include the plan of conversion, which is the key element of an application.<sup>355</sup>

If a depository institution seeks to convert to a North Carolina bank charter, the BLMA requires that the Commissioner approve both the plan of conversion<sup>356</sup> (after considering several factors)<sup>357</sup> and the plan's consummation.<sup>358</sup> The Commissioner may require amendment of

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353. N.C. GEN. STAT. § 53C-7-301(b) (Supp. 2012).

354. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), 12 U.S.C. §§ 214 *et seq.*, 1464(i) (Supp. V 2011).

355. See § 53C-7-301(b) (Supp. 2012).

356. See *id.*

357. See § 53C-7-301(c). To approve a conversion, the Commissioner must determine that:

“(1) The resulting bank will commence operations in a safe, sound, and prudent manner with adequate capital, liquidity, reserves, asset composition, and earnings prospects.

(2) The directors and officers of the converting institution are qualified by character, competency, and experience to control and operate the resulting bank in a legal and proper manner.

(3) The interests of the converting institution's customers, creditors, and shareholders will not be materially and adversely affected by the proposed conversion.

(4) The plan of conversion is not in violation of the converting institution's applicable organizational law.

(5) Adequate written disclosure of the material terms of the plan of conversion and other relevant material information has been or will be made to the converting institution's equity ownership interest holders as required by the converting institution's organizational law, including a statement in any such written disclosure that any materials used to solicit the votes of the holders have not been approved by the Commission or the Commissioner and that any representation to the contrary is a criminal offense.” *Id.*

358. § 53C-7-301(e).

the plan.<sup>359</sup> Following approval of a plan, the Commissioner monitors the conversion process,<sup>360</sup> and may approve the consummation subject to certain conditions.<sup>361</sup>

The BLMA also requires that adequate and complete disclosures about material information be given to the converting institution's equity ownership interest holders, and include a statement that the soliciting materials have not "been approved by the Commissioner and that any representation to the contrary is a criminal offense."<sup>362</sup> This provision probably will require the Commissioner to review proxy solicitation materials used in conversions.<sup>363</sup>

The BLMA does not require that the Banking Commission approve a conversion.<sup>364</sup> The Commissioner's denial of a charter conversion application may be appealed to the Banking Commission in pursuant to the procedure set forth in Section 53C-2-6.<sup>365</sup>

A conversion also may require a notification or application with the "outgoing" regulator, as is the case for federal savings associations regulated by the Office of the Comptroller of the Currency.<sup>366</sup>

## 2. Conversion from Bank

A state bank may convert to another depository institution under the laws of North Carolina, of another state, or of the United States.<sup>367</sup> No application to OCOB is required for such a conversion under the BLMA,<sup>368</sup> but once a conversion is effective the converted institution must immediately notify the Commissioner and file a copy of the

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359. § 53C-7-301(b).

360. § 53C-7-301(d).

361. § 53C-7-301(f).

362. § 53C-7-104(b)(6) (banks); § 53C-10-105(b)(6) (bank holding companies).

363. The BLMA contains a similar provision for conversions. It does not include such a provision for bank formations or for combinations involving banks.

364. Although the BLMA does not contain explicit language requiring that the Banking Commission approve an application of an existing depository institution to convert to a North Carolina chartered commercial bank, the OCOB may interpret the BLMA to require this approval.

365. See § 53C-7-302.

366. 12 C.F.R. §§ 152.19, 163.22 (2012) (conversion of stock association).

367. § 53C-7-303.

368. The Commissioner would review an application for conversion to a North Carolina savings bank under Article 3 of Chapter 54C of the North Carolina General Statutes, or to a savings and loan association under N.C. GEN. STAT. § 54B-34.1 (2011).



conversion authorization issued by the applicable regulator.<sup>369</sup>

### 3. Comparison to Old Law

The Old Law's conversion provisions were more detailed, but probably less comprehensive, than the BLMA provisions.<sup>370</sup> The Old Law required that the Commissioner's decision on an application for conversion was subject to review by the Commission, but it did make such review mandatory.<sup>371</sup>

The Old Law explicitly required that a mutual institution convert to a stock institution before becoming a bank.<sup>372</sup> A mutual to stock conversion would take place under the law governing the institution seeking to convert to a bank. The BLMA implicitly requires the prior mutual to stock conversion because Chapter 53C has no provision for a mutual bank.<sup>373</sup>

The Old Law only provided for conversion of a bank into a national bank.<sup>374</sup> The BLMA allows a bank to convert into any kind of depository institution under the laws of North Carolina, another state, or the United States.<sup>375</sup> The Old Law provided rights to dissent from a conversion and receive payment for stock at an appraised value.<sup>376</sup> The BLMA does not provide for dissent and appraisal in a conversion.

## IX. ORGANIZATION AND AUTHORITY OF THE COMMISSION AND THE OCOB

Article 2 of the BLMA provides for the OCOB's organization and administration, issuance of rules, and conduct of hearings. Article 8 provides for supervision of banks and enforcement of the banking laws. Article 9 provides for supervisory combinations and for dissolution and

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369. N.C. GEN. STAT. § 53C-7-303(b) (Supp. 2012).

370. See N.C. GEN. STAT. § 53-17.2 (repealed 2012) (conversion to bank); § 53-16 (repealed 2012) (consolidation, conversion, or merger with national banks).

371. § 53-17.2(d) (repealed 2012).

372. § 53-17.2(b) (repealed 2012).

373. North Carolina law on Savings Banks, in contrast, provides for the formation of either a mutual or stock savings bank, N.C. GEN. STAT. § 54C-10 (Supp. 2012), and for conversions from mutual to stock form and vice versa. See § 54C-33-34.

374. N.C. GEN. STAT. § 53-16 (repealed 2012). The law also addressed consolidations and mergers with national banks.

375. N.C. GEN. STAT. § 53C-7-303(a) (Supp. 2012).

376. N.C. GEN. STAT. § 53-16(c) (repealed 2012).

liquidation of banks.

*A. Organization and Administration*

1. Composition of the Commission

The BLMA provides for a 15 member State Banking Commission,<sup>377</sup> reducing the 22-person Commission under the Old Law.<sup>378</sup> The State Treasurer continues to serve as an ex officio member and chair of the Commission,<sup>379</sup> as under the Old Law.<sup>380</sup> Twelve members are appointed by the Governor, three of whom must be “practical bankers,” one of whom must be a “consumer finance licensee,” and eight of whom shall be “public members.”<sup>381</sup> Two members are appointed by the General Assembly, one on the recommendation of the President Pro Tempore of the Senate and the other on the recommendation of the Speaker of the House, each of whom must be a practical banker.<sup>382</sup>

A practical banker is a person who, at the time of appointment, is, or within the previous five years has been, a president, CEO, director, or owner of five percent or more of a class of voting securities of a “North Carolina financial institution.”<sup>383</sup> The BLMA does not define the term “consumer finance licensee;” however, the term appears to refer to a person licensed under the North Carolina Consumer Finance Act to conduct a consumer finance business.<sup>384</sup> The Clarifications Bill may provide a definition for this term. A public member is a person who is not a practical banker at the time of appointment and has not been one within the previous five years.<sup>385</sup>

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377. N.C. GEN. STAT. § 53C-2-1(a) (Supp. 2012).

378. N.C. GEN. STAT. § 53-92(b) (repealed 2012).

379. N.C. GEN. STAT. § 53C-2-1(a), (b) (Supp. 2012).

380. N.C. GEN. STAT. § 53-92(b) (repealed, effective Apr. 1, 2013).

381. N.C. GEN. STAT. § 53C-2-1(a) (Supp. 2012).

382. *Id.*

383. § 53C-1-4(56). A “North Carolina financial institution” is a bank, savings institution, or trust company organized under North Carolina law. § 53C-1-4(47). Under the Old Law, a distinction was drawn between banks and savings institutions: bankers got number of seats, and two were reserved for the chief executive officers of savings institutions. Theoretically, all the practical bankers on the Commission now could be CEOs of either banks or of savings institutions.

384. N.C. GEN. STAT. §§ 53-164 to -191.

385. N.C. GEN. STAT. § 53C-1-4(58). The Old Law provided that public members were

## 2. Powers of the Commission and Conduct of Business

The BLMA generally empowers the Commission to supervise and review the exercise of all powers and duties vested in or exercised by the Commissioner.<sup>386</sup> The Commission meets as it prescribes for itself by resolution, and at least every three months, and may be called to special meetings either by the Governor or the Commissioner.<sup>387</sup> A majority of the Commission constitutes a quorum, and a quorum includes the State Treasurer and members disqualified by personal interest from participating in a decision under the State Government Ethics Act.<sup>388</sup>

## 3. The Commissioner and the OCOB

The Governor appoints the Commissioner for a four year-term beginning April 1, 2011, subject to confirmation by joint resolution of the General Assembly, and his or her salary is set by the General Assembly.<sup>389</sup> The Commissioner is aided by one or more deputy commissioners, one of whom must be a chief deputy commissioner. The chief deputy commissioner has the powers delegated to him or her by the Commissioner. The chief deputy commissioner fulfills the duties of the Commissioner, if the Commissioner position becomes vacant or the Commissioner is unable to function, until the Governor appoints an acting Commissioner.<sup>390</sup> All deputy commissioners may be appointed or removed in the Commissioner's discretion.

The Commissioner also may employ examiners, investigators, counsel, and other employees, who with the Commissioner constitute the OCOB. The OCOB employees are exempt from certain provisions of state personnel rules relating to classification and compensation. The Commissioner also may engage agents and independent contractors, and

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to be "representatives of the borrowing public," who were "selected so as to fully represent the consumer, industrial, manufacturing, professional, business and farming interests of the State." N.C. GEN. STAT. § 53-92(b) (repealed, effective April 1, 2013). Note that under BLMA, a consumer finance licensee appears eligible for appointment as a public member, which probably was not intended. The Clarifications Bill may address that ambiguity.

386. N.C. GEN. STAT. § 53C-2-1(e).

387. § 53C-2-1(b).

388. *Id.* (referencing N.C. GEN. STAT. 138A-38 (2011)).

389. N.C. GEN. STAT. §§ 53C-2-2(a), -3(c) (Supp. 2012).

390. N.C. GEN. STAT. § 53C-2-3(a)-(b) (Supp. 2012).

may conduct the OCOB's work through employees of other government agencies.<sup>391</sup>

The OCOB is funded through the assessments it levies on the institutions it regulates, and the Commission approves the OCOB's budget.<sup>392</sup> North Carolina banks are charged annual assessments based on total assets shown on their call reports, and on trust assets that are not real estate.<sup>393</sup> The Commission must adjust the fees levied on different institutions it regulates based on the estimated costs of regulating those institutions.<sup>394</sup> The Commissioner may impose a special assessment on a bank if circumstances call for an increased level of supervision for that bank.<sup>395</sup>

### *B. Rules and Guidance*

The BLMA authorizes the Commissioner to make rules with respect to any institution the Commissioner regulates, but subject to the approval of the Commission. This broad provision is in addition to any specific authority granted to the Commissioner under particular statutes.<sup>396</sup> These rules are subject to Article 2A of the Administrative Procedure Act ("APA"),<sup>397</sup> so all rules must be approved by the Rules Review Commission.<sup>398</sup> That review process has become rather arduous.

The BLMA also provides:

Upon written request, the Commissioner may, notwithstanding any other provision of law to the contrary, issue letters of interpretation, advisory opinions, or written guidance on any laws under the Commissioner's jurisdiction, provided that the interpretations, opinions, and guidance shall not have

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391. § 53C-2-3(a), (c).

392. § 53C-2-4.

393. § 53C-8-2(1)-(2).

394. § 53C-8-2(4).

395. § 53C-8-2(3).

396. § 53C-2-5.

397. N.C. GEN. STAT. §§ 150B-18 to -21.28 (2011)

398. See §§ 150B-21.1 to -.14.

the force and effect of rules of law.<sup>399</sup>

This provision should be eliminated.<sup>400</sup> It is unnecessary to state that these issuances do “not have the force and effect of rules of law,” but if such “guidance” were considered a declaratory ruling under the APA, this provision could be interpreted to undermine the provision of the declaratory rulings statute that a declaratory ruling it is binding on the agency and may only be changed prospectively.<sup>401</sup>

### C. *Hearings*

The Commissioner is required to hold certain hearings, and permitted to hold others, under the banking laws, and the BLMA authorizes those hearings under Article 3A of the APA.<sup>402</sup> Under this article, as opposed to Article 3 which applies to administrative hearings of all agencies not listed in Article 3A,<sup>403</sup> the Commissioner or a designated staff member (“other suitable person”) may hear the contested case rather than an administrative law judge (ALJ). An ALJ may be requested to hear a matter, in which case the ALJ only makes a recommended decision, and the Commission enters a final decision which may be contrary to the ALJ’s recommendation.<sup>404</sup>

The Commissioner’s decision may be appealed to the Commission for review; notice of appeal generally must be given within 20 days of the order, although some decisions must be appealed in a shorter time period.<sup>405</sup> The BLMA requires that an appellant state both the grounds for appeal and list numbered assignments of error. The Commission may dismiss the appeal if the appellant fails to “comply with the briefing schedule provided by the Commission,” which as written seems to give the Commission the power to act arbitrarily. The

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399. N.C. GEN. STAT. § 53C-8-1(c) (Supp. 2012).

400. N.C. GEN. STAT. § 150B-4 (2011).

401. § 150B-4(a).

402. N.C. GEN. STAT. § 53C-2-6(a) (Supp. 2012); N.C. GEN. STAT. §§ 150B-38 to -42 (2011).

403. N.C. GEN. STAT. §§ 150B-22 to -37 (2011).

404. N.C. GEN. STAT. § 53C-2-6(c); N.C. GEN. STAT. §§ 150B-40 , -42 (2011).

405. N.C. GEN. STAT. § 53C3-4(d) (Supp. 2012) (denial of bank formation: 10 days); § 53C-8-14(b) (Commissioner’s assumption of supervisory control: 10 days); § 53C-8-15(d) (removal of director, officer, or employee: 10 days); § 53C-10-301 (holding company cease and desist order: 10 days).

Commission's decision may be appealed to the Superior Court of Wake County, and the appeal is given "precedence over other civil actions." The Superior Court applies a *de novo* standard of review.<sup>406</sup>

*D. Confidentiality of Records*

Article 2 of Chapter 53C provides that the OCOB's records are generally open to inspection and copying by the public, subject to the Commissioner imposing charges necessary to cover the cost of retrieval, copying, and posting.<sup>407</sup> Article 2 then provides for a number of exceptions related to confidential information about bank examinations, investigations, and reports; bank customers, bank directors and employees; and similar matters.<sup>408</sup> Notwithstanding these protections, the OCOB may share information with other state or federal agencies based on a written agreement to keep the information confidential,<sup>409</sup> and a court in a criminal or enforcement proceeding may order records protected from disclosure to be produced, after an *in camera* review and entry of a protective order, if the court finds "that the interests of justice require that the documents be discoverable or admissible in evidence."<sup>410</sup>

A separate provision in Article 4 covers "compliance review committees."<sup>411</sup> This provision brings forward a provision of the Old Law.<sup>412</sup> There is substantial overlap with a similar provision of Article 2.<sup>413</sup> The Article 2 provision is less detailed in its definition of a compliance review committee but more detailed in its provisions for a judicial order allowing disclosure in certain circumstances. The Article 4 provision is more detailed on the scope of its protection.<sup>414</sup>

Commission members are held to the confidentiality requirements of the BLMA.<sup>415</sup> Bank examiners who make unauthorized

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406. N.C. GEN. STAT. § 53C-2-6(c) (Supp. 2012); N.C. GEN. STAT. § 150B-51(b) (2011).

407. N.C. GEN. STAT. § 53C-2-7(a) (Supp. 2012).

408. § 53C-2-7(b).

409. § 53C-2-7(d).

410. § 53C-2-7(e).

411. § 53C-4-12.

412. N.C. GEN. STAT. § 53-99.1 (repealed 2012).

413. N.C. GEN. STAT. § 53C-2-7(b)(8), (e) (Supp. 2012).

414. § 53C-4-12(b).

415. § 53C-2-1(c).

disclosures of information obtained in bank examinations are guilty of a Class 1 misdemeanor.<sup>416</sup>

Banks are allowed to disclose their state examination ratings to an insurance carrier for the purpose of obtaining coverage if the insurance carrier “agree[s] in writing to maintain the confidentiality of the information and not to disclose it in any manner whatsoever.”<sup>417</sup> It is important to note that this provision does not authorize the disclosure of examination reports or the release of ratings issued by a federal regulator.<sup>418</sup>

### *E. Supervision and Enforcement*

#### 1. General Powers of Commissioner

Article 2 provides that the Commissioner is the CEO of the Commission and has “the powers enumerated in this Chapter and otherwise provided by North Carolina law and such other powers as may be necessary for the proper discharge of the Commissioner’s duties, including the power to enter into contracts.”<sup>419</sup> The Commissioner is empowered to subpoena witnesses and compel their attendance, require production of evidence, and examine persons under oath,<sup>420</sup> and to sue and prosecute or defend actions in state and federal courts.<sup>421</sup> Generally, “[t]he Commissioner may exercise any jurisdiction, supervise, regulate, examine, or enforce any State consumer protection laws or federal laws with respect to which the Commissioner has enforcement jurisdiction.”<sup>422</sup>

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416. § 53C-8-8.

417. § 53C-2-7(f).

418. There is no corresponding exception under federal law permitting the disclosure of reports of examination or CAMELS scores to insurance underwriters. See 12 C.F.R. pt. 309; see also Financial Institution Letter FIL-13-2005, Feb. 28, 2005 (stating that disclosure of CAMELS scores to insurance companies is prohibited by federal law and subject to the criminal penalties provided in 18 U.S.C. § 641).

419. § 53C-2-2(b).

420. § 53C-2-2(c).

421. § 53C-2-2(d).

422. *Id.* The defined term “banking law,” which means any law the Commissioner is authorized to enforce, should have been used here instead because the Commissioner is authorized to enforce many laws that would not be characterized as “consumer protection laws.” The Clarifications Bill may make the correction; see also Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), 12 U.S.C. §§ 214 *et seq.*, 1464(i) (Supp. V 2011).

## 2. General Powers to Supervise Banks

Article 8 of Chapter 53C<sup>423</sup> sets out the broad powers of the Commissioner to supervise banks, similar to the provisions of the Old Law.<sup>424</sup> The BLMA does not impose duties or bestow powers on the Commissioner and the OCOB powers that differ greatly in quality from the duties and powers provided under the Old Law, but organizes the duties and powers much more coherently. The BLMA does not bring forward the moribund provisions of the Old Law requiring bank examiners to make arrests for violations of the banking laws.<sup>425</sup>

Generally, “the Commissioner’s duty [is] to enforce the banking laws through the employees and agents” of the OCOB.<sup>426</sup> The BLMA further provides:

The Commissioner may enter into written agreements, cease and desist order stipulations, cease and desist orders, consent orders, and similar arrangements with banks and their holding companies, or either of them; may request resolutions be approved by boards of directors of banks and their holding companies, or either of them; and may take other similar corrective actions.<sup>427</sup>

## 3. Powers to Review and Examine

The BLMA also sets out a number of specific but very broad powers of the Commissioner and the OCOB to acquire information. In particular, it bestows on the Commissioner and the OCOB the power to require all banks to submit annual and other periodic reports, but not for

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423. §§ 53C-8-1 to -17.

424. *See generally* N.C. GEN. STAT. §§ 53-92 to -116 (repealed 2012, except for N.C. GEN. STAT. § 53-92, which is repealed effective Apr. 1, 2013). Banks established prior to the date of the BLMA must comply with its provisions, but may continue operating under their original organizational documents. N.C. GEN. STAT. § 53C-1-3(a) (Supp. 2012).

425. N.C. GEN. STAT. § 53-121 (repealed 2012).

426. N.C. GEN. STAT. § 53C-8-1(a) (Supp. 2012). The BLMA defines “banking laws” as “[a]ll laws which the Commissioner or the OCOB is authorized to enforce under any applicable statute.” § 53C-1-4(9).

427. § 53C-8-1(b).



periods of less than one month,<sup>428</sup> and gives the Commissioner the power to examine (1) banks and bank holding companies, in coordination with federal banking regulators,<sup>429</sup> and (2) bank affiliates to “the extent it is necessary to safeguard the interest of depositors and creditors of the bank and of the general public, and to enforce the provisions of” the BLMA.<sup>430</sup> Additionally, the BLMA bestows on the Commissioner the power to (1) require free access to, and production of, books and records, (2) subpoena witnesses and records, (3) administer oaths, and (4) compel compliance.<sup>431</sup> Furthermore, the BLMA allows the Commissioner and OCOB to enter into cooperative agreements with other bank supervisory agencies.<sup>432</sup>

#### 4. General Enforcement Powers

Article 8 also gives the Commissioner and the OCOB extremely broad enforcement powers, all of which are subject to oversight by the Commission. Specifically, these include the power to make special examinations or investigations if “the Commissioner believes that a violation of the banking laws has occurred or is continuing”<sup>433</sup> and impose fines for late reports.<sup>434</sup> Additionally, the Commissioner and the OCOB have the power to order banks and trust companies—and their directors, officers, and employees—to cease and desist from (1) “violating any provision of this Chapter or any lawful rule issued thereunder”<sup>435</sup> or (2) “a course of conduct that is unsafe or unsound and that is likely to cause insolvency or dissipation of assets or is likely to jeopardize or otherwise seriously prejudice the interests of a depositor.”<sup>436</sup> Article 8 further empowers the Commissioner and OCOB to impose fines for violations of cease and desist orders<sup>437</sup> and, after notice of and an opportunity for a hearing, impose larger fines for

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428. § 53C-8-3.

429. § 53C-8-4.

430. § 53C-8-5. An “affiliate” is any entity controlling, controlled by, or under common control with a bank. § 53C-1-4(3). *Cf.* 12 U.S.C. § 1820(b)(4) (similar power for FDIC).

431. §§ 53C-8-6, -12(e).

432. § 53C-8-17.

433. § 53C-8-12(a).

434. § 53C-8-12(b).

435. § 53C-8-12(c)(1).

436. § 53C-8-12(c)(2).

437. § 53C-8-12(f).

violation of an order issued by the Commission or the Commissioner.<sup>438</sup> In the event of an emergency, the Commissioner may waive or suspend requirements.<sup>439</sup> The Commissioner ordinarily must give notice and an opportunity for hearing before exercising these powers, but may “promptly afford a subsequent hearing” in “cases involving extraordinary circumstances requiring immediate action.”<sup>440</sup>

### 5. Power to Remove Directors

Article 8 provides that the Commissioner may issue and order temporarily removing a bank director, officer, or employee the Commissioner finds

has participated in or consented to any violation of this Chapter or an order of the Commissioner, or has engaged in any unsafe or unsound business practice in the operation of the bank, or has been dishonest, incompetent, or reckless in the management of the affairs of the bank, or has persistently violated the laws of this State, or repeatedly violated or failed to comply with any of the bank’s organizational documents, and that as a result, a situation exists requiring prompt corrective action in order to protect the bank, its customers, or the public, but the Commissioner must hold a hearing within 10 days of the temporary removal.<sup>441</sup>

At the conclusion of the hearing, the Commissioner either dissolves the removal order or makes it permanent.<sup>442</sup> Notice of appeal to the Commission must be given within 10 days rather than the usual 20 days.<sup>443</sup>

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438. § 53C-8-12(h).

439. § 53C-8-16.

440. § 53C-8-12(d).

441. § 53C-8-15(a). The Commissioner may grant the temporarily removed person an additional 10 days to prepare for the hearing. *Id.*

442. *Id.* Removal of a director is effective as if the removal were authorized by shareholders. § 53C-8-15(b).

443. § 53C-8-15(d).

## 6. Capital and Safety and Soundness Emergencies

Article 8 empowers the Commissioner to issue cease and desist orders and order immediate corrective action if a bank (a) has “inadequate capital,”<sup>444</sup> (b) has “insufficient capital,”<sup>445</sup> or (c) the Commissioner “determines that immediate action is necessary to cause a bank to conduct its business in a safe and sound manner or to cause a bank or any of its directors, officers, or employees to cease from an act or course of conduct that threatens, or is reasonably probable of threatening, the financial integrity of the bank.”<sup>446</sup> These orders may be issued without a hearing, but the Commissioner “shall promptly afford a subsequent hearing.”<sup>447</sup>

The Commissioner is empowered to seek supervisory control over a bank if the Commissioner determines that the bank (a) has insufficient capital and (b) “is conducting its business in an unsafe or unsound manner or in any fashion that threatens the financial integrity of the bank.”<sup>448</sup> To pursue supervisory control, the Commissioner must issue a show cause order and quickly hold a hearing.<sup>449</sup> If the Commissioner determines after the hearing “that supervisory control of the bank is necessary to protect the bank’s customers, creditors, or the general public,” the Commissioner enters an order of supervisory control.<sup>450</sup> Notice of appeal to the Commission must be given by the Bank’s Board of Directors within 10 days, rather than the usual 20 days.<sup>451</sup> The Commissioner may appoint an agent for the exercise of supervisory control,<sup>452</sup> and within 180 days from entry of that order the Commissioner must approve a plan for termination of supervisory control within 30 days of the approval. The plan may include provisions for additional capital, changes in officers or directors, reorganization or combination with another entity, a control transaction, or dissolution and liquidation.<sup>453</sup>

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444. Less than 100%, but not less than 75%, of required capital. § 53C-1-4(41).

445. Less than 75%, of required capital. § 53C-1-4(43).

446. § 53C-8-13(a).

447. § 53C-8-13(b).

448. § 53C-8-14(a).

449. *Id.*

450. § 53C-8-14(b).

451. § 53C-8-15(b).

452. § 53C-8-14(c).

453. § 53C-8-14(d).

## 7. Criminal Laws

Article 8 of Chapter 53C makes it is a felony to misapply or embezzle funds, make false entries, or take other actions with respect to bank assets, records or reports “with intent to defraud or injure a bank or any other person or with intent to deceive an officer of the bank or an employee of the OCOB appointed to examine the affairs of the bank.”<sup>454</sup> Offenses involving values of \$100,000 or more are Class C felonies; offenses involving less than \$100,000 in value are Class H felonies.<sup>455</sup>

Article 8 brings forward the provision of the Old Law<sup>456</sup> designed to prevent runs on banks:

Any person who shall willfully and maliciously make, circulate, transmit, or otherwise communicate any statement, rumor, or suggestion to one or more other persons that is directly or by inference false and derogatory to the financial condition, or affects the solvency or financial standing, of any bank, or who shall counsel, aid, procure, or induce another to make, circulate, transmit, or otherwise communicate any such statement or rumor, shall be guilty of a Class 1 misdemeanor.<sup>457</sup>

Article 8 brings forward the provisions of the Old Law<sup>458</sup> making intentional false reports and acceptance of bribes by bank examiners Class H felonies,<sup>459</sup> and making it a Class I misdemeanor for a bank officer to give a loans or gratuity to a bank examiner, or for a bank examiner to accept a loan or gratuity.<sup>460</sup> The BLMA adds a sensible exception for loans in existence at the time of the hiring of the examiner that were made on normal terms and conditions.<sup>461</sup>

The BLMA does not set forth criminal provisions comparable to

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454. § 53C-8-11(a).

455. § 53C-8-11(b).

456. N.C. GEN. STAT. § 53-128 (repealed 2012).

457. N.C. GEN. STAT. § 53C-8-10 (Supp. 2012).

458. N.C. GEN. STAT. §§ 53-124, -126 (repealed 2012).

459. N.C. GEN. STAT. § 53C-8-7 (Supp. 2012).

460. § 53C-8-9(a).

461. § 53C-8-9(b).

the Old Law's provisions making it (a) a Class I felony for an officer or employee of a bank to receive, or for an officer to permit an employee to receive, any money, checks, drafts or other property as a deposit when he or she had knowledge that the bank was insolvent,<sup>462</sup> and (b) unlawful for a bank to advertise a larger capital stock than had actually been paid to it in cash.<sup>463</sup>

The Commissioner may refer any violations of criminal statutes to appropriate prosecutorial agencies.<sup>464</sup>

## 8. Bank Holding Companies

The BLMA did not repeal or amend the North Carolina Bank Holding Company Act.<sup>465</sup> Article 10 of the BLMA imposes similar provisions, and the resulting redundancy and slight inconsistency may be addressed by the Clarifications Bill.<sup>466</sup>

Article 10 of Chapter 53C requires “[e]very holding company of a bank” to register with the Commissioner. The definitions of “holding company”<sup>467</sup> and “bank”<sup>468</sup> do not limit the registration to holding companies operating with subsidiaries in North Carolina, as does the North Carolina Bank Holding Company Act.<sup>469</sup> But the BLMA registration requirement is subject to some ambiguity because it is located in Part 1, titled “Change in Control.”

Article 10, Part 3 contains a cease and desist provision<sup>470</sup> very similar to the one in the North Carolina Bank Holding Company Act.<sup>471</sup> The North Carolina Bank Holding Company Act provides for fines of \$1,000 per day; the BLMA statute provision provides for \$20,000 per day fines. The North Carolina Bank Holding Company Act provision also applies to nonbank subsidiaries of bank holding companies; the BLMA provision does not.

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462. N.C. GEN. STAT. § 53-132 (repealed 2012).

463. § 53-133 (repealed 2012).

464. N.C. GEN. STAT. § 53C-8-12(i) (Supp. 2012).

465. See N.C. GEN. STAT. § 53-225 to -232 (2011).

466. *Id.*

467. N.C. GEN. STAT. § 53C-1-4(39) (Supp. 2012).

468. § 53C-1-4(4).

469. N.C. GEN. STAT. § 53-227 (2011).

470. N.C. GEN. STAT. § 53C-10-301 (Supp. 2012). The numbering sequence in Article 10 was changed because it is divided into parts.

471. N.C. GEN. STAT. § 53-228 (2011).

## 9. Non-banking entities

The BLMA prohibits use by any person of “the term ‘bank,’ ‘savings and loan,’ ‘savings bank,’ ‘banking company,’ ‘trust company,’ or words of similar meaning that lead the public reasonably to believe that it conducts the business of a depository institution or trust institution” by any person not authorized to conduct that business.<sup>472</sup> The Commissioner is empowered to seek an injunction to prohibit violations of this prohibition.<sup>473</sup> Violations of similar provisions of the Old Law were misdemeanors.<sup>474</sup>

### *F. Supervisory Combinations, Dissolutions and Liquidation*

Part 1 of Article 9 provides the Commissioner with the authority to authorize or require the combination of a bank with another institution “upon making a finding that a bank is unable to operate in a safe and sound manner and is not reasonably likely to be able to resume safe and sound operations.”<sup>475</sup> A vote of the shareholders would not be required. The statute does not make clear whether a hearing is required for the Commissioner to make this finding. Presumably, as with federal takeovers, a hearing is not required. As a practical matter, it is all but certain that this power would be used only in conjunction with a federal regulator, which would have to approve the transaction – and continued deposit insurance – under the provisions of federal law.

Part 2 of Article 9 brings forward the provisions of the Old Law<sup>476</sup> for voluntary dissolution and liquidation.<sup>477</sup>

Finally, Part 3 of Article 9 brings forward the provisions of the Old Law<sup>478</sup> on receivership and involuntary dissolution and liquidation.<sup>479</sup> As a practical matter, the Commissioner will never undertake to dissolve and liquidate a bank other than in a transaction in conjunction with federal regulators in which FDIC insurance is made

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472. N.C. GEN. STAT. § 53C-1-3(b) (Supp. 2012).

473. § 53C-1-3(c).

474. N.C. GEN. STAT. § 53-127(d) (repealed 2012).

475. N.C. GEN. STAT. § 53C-9-101 (Supp. 2012). The numbering sequence in Article 9 was changed because it is divided into parts.

476. N.C. GEN. STAT. § 53-18 (repealed 2012).

477. N.C. GEN. STAT. §§ 53C-9-201 to -409 (Supp. 2012).

478. N.C. GEN. STAT. §§ 53-19 to -36 (repealed 2012).

479. N.C. GEN. STAT. §§ 53C-9-301 to -409 (Supp. 2012).

available. Part 3 authorizes the Commissioner to “appoint the FDIC or its nominee as the receiver,” and “thereafter be forever relieved of any and all responsibility and liability in respect to the receivership and liquidation of the bank.”<sup>480</sup> As we have seen in recent years, when a state regulator appoints the FDIC as receiver, the FDIC receivership rules apply.

## X. CONCLUSION

The BLMA finally swept away the cobwebs of the early 20th century North Carolina banking laws, and established a modern code for board governance; capital, reserve, and dividends; powers, activities, and investments; operations; mergers and acquisitions; changes in control of banks and bank holding companies; formation of banks and charter conversions; and the organization and authority of OCOB. North Carolina banks should thank and commend OCOB and the Study Commission for wielding the broom. A few cobwebs and dust balls remain, and it is to be hoped that the Clarifications Bill and updates to the North Carolina Administrative Code will finish the job.

Although it is important that North Carolina bankers and banking lawyers understand these changes, the good news is that the BLMA imposes few significant regulatory burdens, and relieves North Carolina banks of many outmoded restrictions and ambiguities. It should be the case that bankers have to make few major adaptations to comport with the BLMA provisions. The most significant challenge for bankers may be complying with some of the provisions involving new activities, non-branch business offices, and subsidiaries.

The most significant improvements of the BLMA may be those that align bank corporate governance more closely with the general business corporation law, including those changes which remove incentives for banks to form or maintain bank holding companies.

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480. § 53C-9-301(d).