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Litigation & Arbitration and Financial Institutions Regulation Groups

Client Alert

New York State Executive Order 202.9 Affecting Bank Loans

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On Saturday, March 21, 2020, New York State Governor Andrew M. Cuomo issued Executive Order 202.9 (the "Order") purporting to modify Section 39 of the New York State Banking Law ("Banking Law") in response to the COVID-19 pandemic. A copy of the Order is available here.

Among other things, the Order grants the Superintendent of the New York Department of Financial Services ("DFS") authority to declare it an "unsound business practice" for "banks" to deny 90-day loan forbearances to persons and businesses affected by the COVID-19 pandemic.

It is unclear at this early stage what "banks" the Order covers. Read narrowly, the Order applies only to those DFS-regulated entities meeting the definition of "bank" under Banking Law § 2. Such "banks" comprise insured depository institutions that operate pursuant to a New York State charter, and are mostly (but not entirely) smaller banks that are unlikely to have large-scale commercial lending business with national or multinational borrowers.

However, as discussed further below, the circumstances of the Order's issuance and the mechanism by which it is to be enforced suggest that it is likely intended to apply more broadly, and that it could potentially require other lenders and creditors, including New York state-licensed branches and agencies of large foreign banking organizations, to grant forbearances to borrowers or other commercial counterparties. It is also possible that, notwithstanding the Order's facially narrow applicability, the DFS Superintendent will interpret it to apply to entities besides those "banks" defined in Banking Law § 2, such as licensed non-bank lenders. **Pending further guidance, institutions that are "subject to the jurisdiction of the [DFS]," such as New York-licensed foreign bank branches and agencies, should assume they could be held to have engaged in an "unsound business practice" by failing to grant**

forbearances pursuant to the Order. We believe that the Order likely will not be interpreted to apply to entities not subject to DFS regulation, such as nationally chartered banks, standalone investment banks, and hedge funds, although this may not necessarily prevent borrowers from attempting to invoke it against non-regulated entities.

Below, we summarize the Order and analyze its application to and potential consequences for large-scale commercial lenders. We are continuing to monitor developments and will issue additional commentary as more information becomes available.

Background and Summary of Executive Order 202.9

Banking Law § 39 grants the DFS Superintendent authority to discontinue "unauthorized or unsafe and unsound" business practices by DFS-regulated entities defined in Banking Law § 2, including "banking organizations," "bank holding companies," "registered mortgage brokers," and others.

The Order purports to modify Banking Law § 39 to expand the definition of an "unauthorized or unsafe and unsound" business practice to include failure by "bank[s]" to grant "person[s] or business[es]" loan forbearances. The Order provides:

- "Subdivision two of Section 39 of the Banking Law is hereby modified to provide that **it shall be deemed an unsafe and unsound business practice if, in response to the COVID-19 pandemic, any bank which is subject to the jurisdiction of the Department [*i.e.*, DFS] shall not grant a forbearance to any person or business who has a financial hardship as a result of the COVID-19 pandemic for a period of ninety days.**" (Emphasis added).

The Order does not define a "forbearance," and the term is not explicitly defined in the Banking Law. In a page on its website, the DFS indicates that a forbearance includes situations where a lender "may agree to temporarily agree to reduce or suspend monthly payments for a period of time," where "[at] the end of the forbearance period regular payments will resume and the missed payments will be added on."

The modification is effective from March 21, 2020 through April 20, 2020.[1]

The Order comes two days after DFS issued guidance to the heads of all New York State-regulated financial institutions urging those institutions, "in their capacity as creditors to businesses of all sizes, to work with and provide accommodations to their borrowers during this unprecedented global emergency to the extent reasonable and prudent, including refraining from exercising rights and remedies based on potential technical defaults under material adverse change and other contractual provisions that might be triggered by the COVID-19 pandemic."

Can the Governor Unilaterally "Modify" Banking Law § 39?

The Order purports to derive authority to "modify" Banking Law § 39 from New York's Executive Law § 29-a, which permits the Governor, "[s]ubject to the state constitution, the federal constitution and federal statutes and regulations . . . [to] temporarily suspend [by executive order] any statute . . . during a state

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[1] In addition to addressing bank loans, the Order contains two directives addressing consumer mortgages and credit card and banking fees. Specifically, the Order:

- directs the Superintendent of the New York Department of Financial Services to "ensure under reasonable and prudent circumstances that any licensed or regulated entities provide to any consumer in the State of New York an opportunity for a forbearance of payments for a mortgage for any person or entity facing a financial hardship due to the COVID-19 pandemic"; and
- empowers the Superintendent of the New York Department of Financial Services to "promulgate emergency regulations to direct that, solely for the period of this emergency, fees for the use of automated teller machines (ATMs), overdraft fees and credit card late fees, may be restricted or modified . . . [.]"

disaster emergency, if compliance with such [statute] would prevent, hinder, or delay action necessary to cope with the disaster[.]"

Under the suspension power, the Governor may implement a thirty-day "modification of the requirements," or interpretation, of Banking Law § 39, effectively avoiding the usual notice-and-comment requirement for a rule or regulation promulgated by the DFS Superintendent (*see* Banking Law § 14(n); N.Y. Admin. Proc. Law § 202). Upon the expiry of thirty days, the governor may renew the modification for additional thirty-day periods "upon reconsideration of all of the relevant facts and circumstances."

<u>What "Banks" Does Executive Order 202.9 Cover?</u>

It is not clear what institutions are encompassed in the Order's reference to "banks." In the absence of clear guidance, two readings are possible. As discussed below, a narrower reading based strictly on the language of the Order and definitions incorporated in Banking Law § 39 would limit the Order's applicability to a small set of mostly local and community banks, a group that has limited commercial lending business. However, the Order's ostensible purpose to grant widespread relief from hardship imposed by COVID-19 – as well as the mechanism by which the Order is to be enforced – both suggest it is likely intended to apply to other banks and financial institutions regulated by DFS, potentially including New York State-licensed branches and agencies of foreign banking organizations.

<u>Narrower Reading</u>

The Order refers to regulatory powers vested in the DFS Superintendent by Banking Law § 39, which by its terms covers certain entities defined in Banking Law § 2, including "banking organizations."[2] Under Banking Law § 2, "banking organizations" includes "banks," defined as "any corporation, other than a trust company, organized under or subject to the provisions of [Article 3]" of the Banking Law. Banking Law Article 3 sets forth traditional powers and obligations of retail-oriented banks, including to accept customer deposits and maintain safety deposit boxes.

Strictly construed, the Order applies only to "banks" as that term is defined in Banking Law § 2 and incorporated by reference into Banking Law § 39 – *i.e.*, entities "organized under or subject to" Article 3. The DFS maintains a list, available at this link, of 45 such "banks." Under a narrow reading, the Order would have little impact on other DFS-regulated entities such as foreign banks that maintain licensed branches and agencies in New York. The Order also would not require non-DFS-regulated entities, such as nationally chartered banks, standalone investment banks, and hedge funds, to grant forbearances.

<u>Broader Reading</u>

Two factors suggest, however, that the Order is likely intended to reach beyond the "banks" defined in Banking Law § 2, and that the DFS Superintendent may interpret it to apply to larger lenders.

First, the ever-broadening scope of the COVID-19 pandemic, and Governor Cuomo's apparent intention to respond to it broadly and decisively (evident from other sweeping directives he has issued in recent days covering many persons and businesses within New York State), suggest the Order is likely intended to apply beyond the relatively small cohort of "banks" defined in Banking Law § 2.

Second, the DFS Superintendent – who is charged with implementing the Order – is the arbiter of "unsafe and unsound conduct," and it would be an odd result for the DFS to be authorized to find that a subset of its regulated institutions (*i.e.*, "banks" defined in Banking Law § 2) were engaged in unsafe and unsound conduct by not granting a forbearance, but not be authorized to make similar findings as to similar

[2] Section 39 covers "any banking organization, bank holding company, registered mortgage broker, licensed mortgage banker, licensed student loan servicer, registered mortgage loan servicer, licensed mortgage loan originator, licensed lender, licensed casher of checks, licensed sales finance company, licensed insurance premium finance agency, licensed transmitter of money, licensed budget planner, out-of-state state bank that maintains a branch or branches or representative or other offices in this state, or foreign banking corporation licensed by the superintendent to do business in this state[.]"

conduct of other licensed or chartered institutions under DFS's purview. Pending further guidance, institutions that are "subject to the jurisdiction of the [DFS]," such as New York-licensed foreign bank branches and agencies, should assume that DFS may argue they have engaged in an "unsound business practice" if they fail to grant 90-day loan forbearances to persons and businesses affected by the COVID-19 pandemic even though such institutions do not meet the definition of "bank" set forth in Banking Law § 2. Lists of DFS-regulated foreign branches and foreign agencies are available at this link.

Notably, Banking Law § 2 does not preclude a broader interpretation of the definition of "bank." Rather, it provides that, as used in the Banking Law, the term "bank" may have a "different meaning" apparent "from the context." But even under the broader, context-dependent construction, the Order should not apply to creditors like nationally chartered banks, standalone investment banks, and hedge funds, which are not regulated by DFS.

Does New York's "Wild Card" Statute Affect the Order's Applicability?

The Banking Law contains a "wild card" statute that provides that state-chartered or licensed banks are permitted to exercise any federally permitted power enjoyed by their federally chartered counterparts.

The freedom *not* to grant forbearances could be considered a "federally permitted power" for purposes of the statute:

> (d) As used in this section, "federally permitted power" shall mean any right, power, privilege or benefit, any activity, or any loan, investment or transaction which a federally chartered banking institution directly or through a subsidiary or subsidiaries, may lawfully exercise or into which it may lawfully engage or enter.

However, the New York wild card statute contains a lengthy DFS approval process. *See* Banking Law § 12-a(3) ("The superintendent shall have **one hundred twenty days** from receipt of the application to determine whether it meets the requirements of this section, provided that such period may be extended for an additional period of time with the written consent of the applicant or applicants.") (emphasis added). Approval of a wild card application also requires DFS to find that the application is "consistent with the policy of the state of New York . . . and thereby protects the public interest, including the interests of . . . consumers." These conditions suggest that, as a practical matter, an application under the wild card statute for an exemption to the Order is unlikely to succeed.

Is the Order Inconsistent With, or Preempted By, Federal Guidance?

The Order is inconsistent in some respects with guidance issued by federal regulators on Sunday, March 22, 2020 encouraging financial institutions to work with borrowers to modify loans extended to customers affected by COVID-19 (but not mandating that such institutions grant forbearances).

Notably, the federal guidance is signed by the Conference of State Bank Supervisors ("CSBS"), of which DFS is a member. Therefore, DFS is tasked with enforcing a state-issued Order that is more onerous in some respects than federal guidance to which it is a party.

Given that the federal/CSBS guidance is styled as guidance and recommendations and does not otherwise state that it preempts any contrary state law requirements, it is unlikely that the Order would be held inapplicable due to the federal-state preemption doctrines. Furthermore, the federal guidance does not fit traditional concepts of preemption (*i.e.*, that national banks subject to federal law may invoke preemption to avoid compliance with inconsistent state law).

We are continuing to monitor this rapidly developing situation and will issue additional updates on the impact of Executive Order 202.9 on lenders and borrowers as more information becomes available. Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or any member of our Litigation & Arbitration and Financial Institutions Regulation Groups.

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