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News Bulletin

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FDIC Proposes to Nix Insurance for Dually Payable Deposits—With an Upside and a Nod to International Cooperation

On February 12, the Federal Deposit Insurance Corporation ("FDIC") proposed for public comment a rule that would exclude from federal deposit insurance coverage those deposits made at insured U.S. banks that are payable at a foreign branch of a U.S. bank, including those deposits that are payable both at domestic and overseas branches ("dually payable deposits"). The rule, however, also is intended to place a U.S. bank's dually payable deposits on an equal depositor preference footing with purely domestic deposits in the event of a bank resolution. The FDIC's action comes in large part as a direct response to action taken by UK regulators last fall to prohibit UK branches of a non-EU bank from taking deposits if those deposits are not accorded depositor preference status under the laws of the bank's home country.

Comments on the FDIC's proposal are due by April 22, 2013. We discuss the particulars and implications of the rule proposal below.

What Happened Last Fall

In September 2012, the UK Financial Services Authority ("FSA") published a consultation paper that, in pertinent part, proposes to prohibit banks from non-EU countries, including U.S. banks, from operating deposit-taking branches in the UK unless UK depositors in such branches are given equal depositor preference priority with home-country depositors in a resolution of the bank. One of the FSA's proposed remedies to address this action would require U.S. banks to change their UK deposit agreements to make such deposits payable both in the UK and the U.S.

The FSA's foreign bank deposit-taking prohibitions should become final in early 2013, albeit with a two-year implementation period. In the interim, however, U.S. banks with UK branches will be required to make relatively detailed disclosures to their UK depositors concerning the Federal Deposit Insurance Act ("FDI Act") national depositor preference regime, including that, upon failure of the U.S. bank, claims for recovery of the bank's UK deposits would be subordinated to claims of the bank's U.S. deposits. U.S. banks that want to continue taking UK branch deposits also will have to disclose the particulars of required revisions to local deposit agreements to assure their dually-payable status.

The FDIC's Proposal

In direct response to the FSA's 2012 action, the FDIC has proposed changes to its deposit insurance regulations (12 C.F.R. Part 330) that would expressly provide that U.S. bank deposits that are paid at an overseas branch, including dually payable deposits, are not covered by federal deposit insurance. By its terms, the FDIC's proposed action would apply to insured U.S. banks that take deposits overseas, and technically would be limited to the insured deposit status of overseas deposits. The FDI Act long has excluded deposits payable at an overseas branch from the definition of "deposit," but has included within the federal definition of "deposit" those deposits that are "carried on the books and records" of an insured bank in the U.S. and are "expressly payable" in the U.S.[1] The FDIC, relying on its broad FDI Act authority to define the meaning of a "deposit" for deposit insurance and other purposes under the FDI Act, now proposes to narrow the exception from the FDI Act "deposit" definitional exclusion to exclude dually payable deposits from the definition of "insured deposit" for purposes of federal deposit insurance coverage.

The FDIC's proposal is a direct response to the FSA's consultation paper, but it also reflects an FDIC concern over the need to manage the exposure of the Deposit Insurance Fund ("DIF") to protect it from global deposit insurance liability, and to assure that the timely payoff of insured deposits in a U.S. bank insolvency is not compromised by potential offshore deposit exposures and cross-jurisdiction administration obstacles. The FDIC has not completely ruled out the possibility of making deposit insurance conditionally available to dually payable deposits (and it has solicited comment on this particular question) if the DIF can be suitably protected from loss, but the agency appears to prefer the straightforward approach of simply excluding such deposits from deposit insurance coverage.

The FDIC's proposal, however, would not change the FDI Act's statutory definition of a "deposit," and dually payable deposits would continue to come within that statutory definition. Accordingly, dually payable deposits would be treated as "deposits" for purposes of the FDI Act's national depositor preference scheme (which has existed since 1993),[2] thus enabling such deposits to rank equally in priority of payment with U.S. uninsured depositors, and ahead of general unsecured creditors, in the event of a U.S. bank insolvency. U.S. bank deposits, however, that are payable solely outside of the U.S. would continue to be subordinated in an insured bank insolvency to deposits that are payable at a U.S. office of the failed U.S. bank. In addition, the FDIC's proposal would have no impact on a U.S. bank's deposit insurance assessment base, inasmuch as assessments post Dodd-Frank generally are calculated by reference to an insured bank's average consolidated total assets minus its average tangible equity, and not its liabilities.[3]

Implications

The FDIC's interest in achieving some level of harmony with cross-border supervisors on global resolution matters is reflected in this recent proposal, which was a direct response not only to the FSA's fall 2012 consultation paper, but also to sectors of the U.S. banking community (those banks with UK deposits) that sought clarity on the depositor preference issue. Historically, U.S. banks have tended to make their offshore deposits payable solely outside of the U.S. in order to avoid, among other things, possible increases in their deposit insurance assessment base, Federal Reserve Board deposit reserve requirements, and sovereign risk liability by reason of the application of section 25(c) of the Federal Reserve Act.[4] In light of the FSA's recent action, however, banks with UK deposits have indicated their intention to change their deposit agreements to make these deposits dually payable, provided that the FDIC would be willing to provide some comfort on the treatment of such deposits under the FDI Act's depositor preference provisions, which the FDIC now appears willing to do.

The FDIC's proposal, if adopted, would not be limited in its impact to U.S. bank deposits held in the UK, but would apply to a deposit held in any offshore jurisdiction that is dually payable. Whether U.S. banks with deposits in other foreign jurisdictions (*e.g.*, Japan, France, Germany) will be tempted to make their foreign deposits dually payable is another matter, inasmuch as such deposits would be subject to deposit reserve requirements (as would UK deposits that are dually payable) that many banks would prefer not to incur. That being said, the

[1] 12 U.S.C. 1813(l).
[2] 12 U.S.C. 1821(d)(11).
[3] It is less clear, however, whether dually payable deposits would be treated as "foreign deposits" for purposes of calculating the long-term unsecured liability adjustments under the risk-based deposit insurance assessment *rate* formula for insured U.S. banks.
[4] 12 U.S.C. 633. This section generally relieves U.S. member banks from liability for deposits "made at a foreign branch" that cannot be repaid by reason of sovereign risk events.

attractiveness to foreign depositors of preferred priority treatment for their deposits in a U.S. bank receivership might provide a commercial impetus for U.S. banks to offer dually payable deposits.[5]

Is there anything in this proposal for foreign banks with U.S. deposits? Probably not—the FDI Act's depositor preference provisions apply by their terms only to insured U.S. banks that are subject to the FDI Act, and it is doubtful that foreign banks that hold uninsured U.S. deposits can derive any legal comfort from the FDI Act framework. Those banks (possibly including foreign banks with uninsured Federal branches regulated by the Office of the Comptroller of the Currency) instead will have to continue looking to state law on the matter of depositor preferences, where the answer not only is state law-dependent, but may not always be the model of clarity.

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[5] As the FDIC helpfully notes, U.S. banks may wish to exclude sovereign risk liability from their dually payable deposit agreements.

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