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TARP, CPFF, TLGP and the U.S. Offices of Non-U.S. Banks

As economic conditions have deteriorated around the world over the past few months, many countries, including the United States, have undertaken initiatives to increase lending, stabilize financial institutions and reassure depositors of the soundness of their financial system.

This month's column will discuss the three major U.S. programs and the ability of non-U.S. bank offices and subsidiaries in the United States to participate in them.

Introduction

The economic benefits non-U.S. banks offer to U.S. workers, businesses and customers may not be immediately apparent to everyone. According to a recent report issued by the trade association, the Institute of International Bankers (IIB), combined banking and nonbanking assets of the U.S. operations of non-U.S. banks totaled almost $5.7 trillion as of Sept. 30, 2007, and, as of Dec. 31, 2006, non-U.S. banks directly employed in the United States nearly 250,000 people.[1] In New York state alone, total assets among all non-U.S. bank operations (including direct offices and commercial bank subsidiaries) totaled over $1.5 trillion as of Dec. 31, 2006.

Moreover, many people do not realize that several of the country's major banking organizations have non-U.S. parents. For example: RBS Citizens Bank NA (1,241 branches, $132 billion in assets) is owned by The Royal Bank of Scotland Group; TD Bank NA (1,084 branches and $98 billion in assets), which is the result of a recent merger between TD Banknorth and Commerce Bank, is owned by the Toronto-Dominion Bank group in Canada; and Harris NA (290 branches, $41 billion in assets) is owned by the Bank of Montreal group in Canada.[2]

TARP

Under the recently enacted Emergency Economic Stabilization Act (EESA), the U.S. Treasury Department (Treasury) instituted the Troubled Asset Relief Program (TARP), and has up to $750 billion to use to purchase "troubled" mortgage-related assets from financial institutions.[3]

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On Oct. 14, 2008, Treasury announced the establishment of the Capital Purchase Program (CPP), which is utilizing $250 billion of TARP funds to make equity investments in "qualifying financial institutions" (QFIs).

EESA defines the term "financial institution" in a manner that includes U.S. banking organization subsidiaries of non-U.S. banks, but not the non-U.S. bank itself. However, in implementing the CPP, Treasury defined a QFI generally as most regulated holding companies and their bank subsidiaries, as well as any U.S.-chartered banking organization not part of a regulated holding company structure, but it excluded U.S. banks and bank holding companies that are controlled by a non-U.S. bank or a non-U.S. company.[4]

The equity investment by Treasury (equal to 1 percent to 3 percent of the institution's risk-weighted assets) takes the form of senior preferred shares with a guaranteed dividend and warrants for common stock. They are callable at par after three years and, while the shares are held by the Treasury Department, there are restrictions on the payment of dividends on other classes of the institution's shares. There also are limitations on executive compensation and "golden parachute" payments for those institutions in which the Treasury Department invests.

Half of the $250 billion is being used to purchase preferred shares in nine of the largest U.S. banking groups, including JPMorgan Chase, Bank of America and Citigroup. As for the remaining $125 million, the Treasury Department and the appropriate federal banking regulators are evaluating applications from other QFIs. The deadline to apply was Nov. 14, 2008, but the deadline for private banks was extended pending issuance of a new term sheet specifically applicable to these categories of banks.

While one can see why a bank that is organized outside of the United States should look to its own home country for any financial stabilization assistance, should a U.S. bank that happens to be owned by a non-U.S. bank or company be shut out? Is it perhaps due to government officials lacking a true understanding of the major economic role that the U.S. operations of non-U.S. banks play in the United States?

Excluding U.S. bank subsidiaries of non-U.S. banks excludes more than just captive bank subsidiaries serving a specialized customer base, it also excludes large commercial banks such as the ones mentioned above that serve a diverse U.S. retail customer base. These U.S. bank subsidiaries of non-U.S. banks are chartered in the United States, operated in accordance with U.S. laws and regulated and supervised by U.S. federal and/or state banking authorities, just like any other insured U.S. banking organization. Some, such as Commerce Bank, have only recently been acquired by a non-U.S. bank. Moreover, as the IIB has pointed out to the Treasury Department, it is unlikely that the home country of the non-U.S. bank would provide it with funds for the purpose of transferring them to a bank outside of the home country. A Treasury equity investment in U.S. banks owned by non-U.S. banks would have the same effect on the U.S. financial system as an equity investment in other U.S. banks—facilitating additional lending.

As noted above, there is legal authority to include U.S.-chartered banks with a non-U.S. bank in the CPP and, in light of recent events by Treasury, without such a change, the U.S. operations of a non-U.S. bank, whether a bank subsidiary or a direct office, may be shut out entirely from the TARP. Why? Originally, it was thought that the remainder of the funds for the TARP would be used to purchase troubled assets such as mortgage-backed securities, and U.S. branches and agencies of non-U.S. banks, and subsidiaries of non-U.S. banks, could have participated. However, on Nov. 12, 2008, Treasury Secretary Henry Paulson stated that the purchase of troubled mortgage-related securities was not the "most effective way" to use TARP funds and that he would continue with equity investments in financial institutions (possibly to include nonbank financial institutions) in order to encourage lending. Secretary Paulson was subject to immediate criticism by those in Congress who expected it to be used for its original purpose, purchasing troubled assets. Meanwhile, on Nov. 14, 2008, Sheila Bair, chair of the Federal Deposit Insurance Corp. (FDIC), unveiled the FDIC's plan to use approximately $25 billion of TARP funds for a home mortgage loan modification program. So, with the use of the remaining TARP funds the subject of an internal U.S. government debate, as of the writing of this column, it remains unclear whether, and in what manner, a U.S. subsidiary of a non-U.S. bank will be able to participate in the TARP.

CPFF

On Oct. 7, 2008, the Federal Reserve Board authorized the Commercial Paper Funding Facility (CPFF) in order to provide a liquidity backstop to U.S. issuers of commercial paper. Under the CPFF, the Federal Reserve Bank of New York (FRBNY) will finance the purchase of unsecured and asset-backed commercial paper from eligible issuers through its primary dealers. The CPFF will finance only U.S. dollar-denominated commercial paper that is rated at least A-1/P-1/F1 by a major nationally recognized statistical rating organization (NRSRO) and, if rated by multiple major NRSROs, is rated at least A-1/P-1/F1 by two or more major NRSROs.

Pricing will be based on the then-current three-month overnight index swap (OIS) rate plus fixed spreads. Loans against unsecured commercial paper will be at a rate of three-month OIS plus 100 basis points, with an annual 100 basis point surcharge fee paid up front. Loans against secured commercial paper will be at a rate of three-month OIS plus 300 basis points, with no credit surcharge fee. The maximum amount of one issuer's commercial paper the special purpose vehicle (SPV) may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between Jan. 1 and Aug. 31, 2008.

The program began Oct. 27, 2008, and will end April 30, 2009, and in order to participate, issuers must register with the CPFF through the FRBNY.[5] A 10 basis point facility fee must be paid upon registration. Proposed participants must register two business days in advance of their intended use of the CPFF.

U.S. banking organization subsidiaries of non-U.S. banks may participate in the CPFF as can the U.S. branches and agencies of non-U.S. banks that directly issue commercial paper. The U.S. branch or agency may not sell to the SPV any commercial paper issued by other parts of the non-U.S. bank.

TLGP

On Oct. 14, 2008, the FDIC an-nounced the Temporary Liquidity Guarantee Program (TLGP) that was designed to "encourage liquidity in the banking system."[6] Under the TLGP, the FDIC is guaranteeing (i) noninterest-bearing transaction deposit accounts, such as payroll processing accounts, and (ii) newly issued senior unsecured debt issued by "Eligible Entities" on or before June 30, 2009. Under the latter program, the eligible debt (which includes promissory notes, commercial paper, interbank funding and any unsecured portion of secured debt), would be fully guaranteed in an amount up to 125 percent of debt that was outstanding as of Sept. 30, 2008, and scheduled to mature before June 30, 2009.

One of the purposes of the program is to encourage liquidity in the banking system and while there is no express requirement that the funds garnered through issuance of this guaranteed debt be used to grant loans, the eligible entities are "encouraged" to use the funds to grant new loans to increase such liquidity.

An "Eligible Entity" for purposes of the TLGP includes:

(1) FDIC-insured depository institutions,

(2) U.S. bank holding companies,

(3) U.S. financial holding companies, and

(4) U.S. savings and loan holding companies that engage only in activities that are permissible for financial holding companies.

If an entity meets the threshold test of eligibility, the FDIC and the institution's primary regulator will review the situation to make a final determination of eligibility.

While all eligible entities are covered without cost to Dec. 5, 2008, (an extension from the original date of Nov. 12, 2008), after that, eligible entities will be assessed a fee to participate in each program: for the senior unsecured debt program, an eligible entity would be charged an annualized fee equal to 75 basis points multiplied by the amount of debt issued under the program. For non-interest-bearing transaction deposit accounts, a 10 basis point surcharge would be added to the eligible entity's existing risk-based deposit insurance premium paid on those deposits.

If an eligible entity does not wish to participate in one or both parts of the TLGP, it must opt out on or before Dec. 5, 2008. The FDIC will post a form on its Web site which eligible entities can use to opt out electronically through the FDICconnect system, a secure Internet channel.

Insured U.S. bank subsidiaries of non-U.S. banks clearly are able to participate. However, the ability of the few remaining insured branches of U.S. banks to participate fully in the TLGP remains unclear. Prior to 1991, non-U.S. banks could receive FDIC insurance for their direct branches in the United States. With the passage of the FDIC Improvement Act of 1991, non-U.S. banks that wish to take initial deposits of less than $100,000 must first establish an insured bank subsidiary.

The FDIC issued an interim rule on Oct. 29, 2008, regarding the TLGP,[7] and excluded FDIC-insured branches of non-U.S. banks from the debt guarantee part of the TLGP, even though the definition of "insured depository institution" in the Federal Deposit Insurance Act specifically includes insured U.S. branches of non-U.S. banks. Moreover, the CPFF includes commercial paper issuances by U.S. branches and agencies of non-U.S. banks; the debt guarantee program of the TLGP merely covers a different type of debt. The IIB submitted a comment letter to the FDIC,[8] pointing out the "potentially serious competitive disadvantage" posed by the exclusion as well as the potential adverse effect on the insured branch's ability to participate in certain interbank lending programs. Comments were due by Nov. 13.

Conclusion

As the economic crisis deepens, there may well be additional programs announced by the United States as well as by state governments. Non-U.S. banks should examine carefully the requirements for each program to determine eligibility of their U.S. operations. If a program appears to exclude the U.S. operations of a non-U.S. bank, raise a question. The exclusion may be due less to an intentional exclusion as opposed to an unintentional exclusion based on a less-than-full understanding of how non-U.S. banks operate in the United States and how much they contribute to the U.S. economy and its residents.

1. Institute of International Bankers, "Economic Benefits to the United States from the Activities of International Banks," February 2008, available on the IIB Web site at www.iib.org.

2. Financial information is as of June 30, 2008, branch information is labeled as "current"; all this information is available through the Institution Directory on the FDIC's Web site, www.fdic.gov.

3. For additional information on TARP, please see the U.S. Treasury's Web site at http://www.treas.gov/initiatives/eesa.

4. Specifically, Treasury defined a QFI as

> (i) Any U.S. bank or U.S. savings association (jointly, banks) not controlled by a Bank Holding Company (BHC), or Savings and Loan Holding Company (SLHC);
>
> (ii) Any U.S. BHC, or any U.S. SLHC that engages only in activities permitted for financial holding companies under the Bank Holding Company Act, and its bank subsidiaries; and
>
> (iii) Any U.S. BHC or U.S. SLHC with certain U.S. bank subsidiaries approved by the Federal Reserve Board.

5. Additional CPFF information and forms are available at http://www.newyorkfed.org/markets/cpff_faq.html.

6. The FDIC Web site has a page devoted to the TLGP: http://www.fdic.gov/regulations/resources/TLGP.

7. See http://www.fdic.gov/regulations/laws/federal/2008/TLGPreg.pdf.

8. The IIB's comment letter is at http://www.fdic.gov/regulations/laws/federal/2008/08c164AD37.pdf.