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Expert Analysis

High Price of 'Retail': Deposits In U.S. Branches of Non-U.S. Banks

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As I have mentioned in previous columns, U.S. branches of non-U.S. banks may not take "retail deposits," which until recently were defined as deposits of less than $100,000. That amount now is $250,000, and U.S. branches of non-U.S. banks were required to put into place, by March 1, 2010, policies and procedures to come into compliance with the new requirements. This month's column will discuss the background for these changes.

Statutory Background

Prior to 1978, there was no requirement that U.S. branches of non-U.S. banks that took deposits carry federal deposit insurance.[1] The International Banking Act (IBA), enacted in 1978, included the requirement that a U.S. branch of a non-U.S. bank obtain deposit insurance from the Federal Deposit Insurance Corporation (FDIC) unless the branch accepted deposits in amounts of $100,000 or more, or either the FDIC (for state-licensed branches) or the Office of the Comptroller of the Currency (OCC) (for OCC-licensed federal branches) determined by law or regulation that the branch was not engaged in "domestic retail deposit activities" requiring deposit insurance protection.[2]

This requirement was tightened in 1991 as part of the Federal Deposit Insurance Corporation Improvement Act of 1991. After Dec. 19, 1991, if a U.S. branch of a non-U.S. bank wished to accept or maintain deposit accounts having balances of less than $100,000, the non-U.S. bank would have to form a U.S. bank subsidiary that maintained FDIC deposit insurance.[3] The U.S. branch itself could no longer obtain FDIC insurance for its deposits, but those branches that had FDIC deposit insurance on Dec. 19, 1991, could retain it. In 2006, that $100,000 figure cited in the statute was replaced by the phrase "standard maximum deposit insurance amount" (SMDIA), which was defined as meaning the maximum amount of deposit insurance as determined under the Federal Deposit Insurance Act (FDIA) for retail banks.[4]

Until October 2008, the SMDIA per ownership category (i.e., sole accountholder, joint accountholder, etc.) was $100,000, subject to a periodic adjustment due to inflation (except for certain retirement accounts, on which the SMDIA had been raised to $250,000).[5] Then, in response to the economic crisis, Congress temporarily raised the SMDIA to $250,000 through Dec. 31, 2009, in the Emergency Economic Stabilization Act of 2008 (EESA).[6] That deadline was extended to Dec. 31, 2013, in the Helping Families Save Their Homes Act of 2009 (HFSTHA). On Jan. 1, 2014, the SMDIA will return to $100,000 (except for those certain retirement accounts).[7]

> The FDIC's linking of the 'retail deposit' threshold to the SMDIA has resulted in immediate compliance costs and system revisions for non-U.S. banks.

Regulatory Background

The FDIC's regulations relating to U.S. branches of non-U.S. banks are located in 12 CFR Part 347, Subtitle B. Even when the threshold was $100,000, certain exceptions allowed U.S. branches of non-U.S. banks to accept initial deposits below $100,000 from the following:

(1) Individuals who are not citizens or residents of the United States at the time of the initial deposit;

(2) Individuals who:

(i) Are not citizens of the United States;

(ii) Are residents of the United States; and

(iii) Are employed by a foreign bank, foreign business, foreign government, or recognized international organization;

(3) Persons (including immediate family members of natural persons) to whom the branch or foreign bank (including any affiliate thereof) has extended credit or provided other nondeposit banking services within the past 12 months or has entered into a written agreement to provide such services within the next 12 months;

(4) Foreign businesses, large U.S. businesses, and persons from whom an Edge or agreement corporation may accept deposits;[8]

(5) Any governmental unit, including the U.S. government, any state government, any foreign government and any political subdivision or agency of any of the foregoing, and recognized international organizations;

(6) Persons who are depositing funds in connection with the issuance of a financial instrument by the branch for the transmission of funds or the transmission of such funds by any electronic means; and

(7) Any other depositor, but only if:

(i) The branch's average deposits under this authority do not exceed 1 percent of the branch's average total deposits, as calculated in accordance with detailed procedures set out in the regulation.[9]

The FDIC regulation is applicable to state-licensed branches of non-U.S. banks. There is a similar OCC regulation with respect to federal branches.[10]

2008-09 Regulatory Changes

After the first increase in the SMDIA in the Emergency Economic Stabilization Act, the FDIC issued interim rules implementing that increase in the FDIC regulations, but did not amend Part 347 at that time. In September 2009, the FDIC issued final rules that included changes to its deposit insurance regulations to reflect the temporary increase in the SMDIA in the Helping Families Save Their Homes Act to $250,000.[11]

Among those sections amended in this rule was Part 347, which was revised to add a reference to the SMDIA, and defining it in the same manner as in the FDIA.[12] While normally there must be notice and comment on issuing or amending regulations, the FDIC took the position that the changes to Part 347 were technical and conforming amendments and thus did not need to be issued for prior notice and comment. The regulations were to be effective Oct. 19, 2010.

Was Change Required?

The FDIC's stated reason for the September 2009 rule was to conform Part 347 to the changes in the International Banking Act made in the 2006 statute substituting "SMDIA" for $100,000. Unfortunately, no additional insight can be gleaned from the September 2009 rule, which simply described these amendments as technical and conforming.

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Nor can much insight be gleaned from the 2006 "conforming amendments."

The deposit insurance requirement for U.S. branches of non-U.S. banks was to "ensure that foreign banking organizations do not receive an unfair competitive advantage over U.S. banking organizations" with respect to taking "retail deposits."[13] The $100,000 figure in 1978 was thought to be the threshold for "wholesale deposits."[14] At the time of the provision's enactment in 1978, the FDIC deposit insurance limit was only $40,000 and was raised to $100,000 at a later date (1980). The fact that the "retail deposit" threshold and the FDIC deposit insurance limit eventually were both $100,000 need not have resulted in permanent correlation between the two numbers going forward. Yet, as a result of the 2006 "conforming amendments," the concept of "retail deposits" is now equivalent to the SMDIA, rather than being an independently determined amount. Even so, the 2006 amendments did not disturb the FDIC's and OCC's statutory authority to determine that deposits that otherwise would fall under the retail deposit definition are not to be considered domestic retail deposits.

The industry argued about the need for the change when there was clear authority for the FDIC and the OCC to exercise discretion and determine that deposit activities between $100,000 and $250,000 were not domestic retail deposit activities requiring deposit insurance protection. The FDIC took the opposite view of the matter, seeing the change as maintaining an equivalence between the two numbers that should not be revisited absent a compelling reason to do so.

Approaching the FDIC

The Institute of International Bankers (IIB), a trade association for non-U.S. banks with U.S. operations, took up the issue with the FDIC. By letter dated Sept. 25, 2009, to FDIC Chair Sheila Bair, the IIB laid out its concerns. The IIB's primary concerns generally fell into three categories:

• The history of the IBA provision demonstrates that the retail deposit figure of $100,000 was not intended to correlate exactly to the SMDIA under the FDIA. Despite the 2006 amendments, the IIB argued that the IBA still gave the FDIC specific authority to determine by order or regulation when a branch would be considered not engaging in domestic retail deposit activities that require FDIC protection.[15] In making this determination, the FDIC was to take into account the size and nature of the deposits and the depositors. Given this authority, and keeping in mind the objective of this section of the IBA (to not give U.S. branches of non-U.S. banks an unfair competitive advantage), the IIB argued that in the absence of evidence that increasing the retail deposit threshold to the current level of the SMDIA is necessary because to leave it at $100,000 would give U.S. branches of non-U.S. banks a competitive advantage over U.S. banking operations, the retail deposit threshold should remain at $100,000.

• The IIB challenged the FDIC's characterization of the amendments to Part 347 as technical, pointing out that these amendments made a substantive change to the operations of U.S. branches of non-U.S. banks and should have been subject to the notice and comment rulemaking process of the Administrative Procedures Act.

• Finally, the IIB raised the practical concern of U.S. branches of non-U.S. banks that had been accepting deposits of between $100,000 and $250,000 while the SMDIA was being raised to $250,000 in 2008. The regulations were not changed until September 2009 and so the IIB questioned whether those U.S. branches of non-U.S. banks that accepted the nonconforming deposits did so in violation of the law and were subject to enforcement actions and civil penalties.

The IIB requested a full airing of these issues with the industry and other regulators before making a final decision. The IIB also pointed out that the OCC, which has the same discretion with respect to federal branches as the FDIC does with state-licensed branches to maintain the retail deposit threshold at $100,000, did not revise its regulations when the FDIC did so.

> The deposit insurance requirement for U.S. branches of non-U.S. banks was to 'ensure that foreign banking organizations do not receive an unfair competitive advantage over U.S. banking organizations' with respect to taking 'retail deposits.'

In a letter dated Oct. 30, 2009, the FDIC offered the IIB the opportunity to present additional evidence to justify retaining the $100,000 retail deposit threshold and provided a grace period until Jan. 14, 2010, during which time the FDIC staff would not recommend enforcement of the amendments to Part 347 raising the retail deposit threshold. The IIB responded by letter dated Dec. 14, 2009, with additional information and again reiterated its primary arguments supporting its position that the FDIC had the statutory authority to retain the retail deposit threshold at $100,000 and that exercising that authority would not result in a competitive disadvantage to U.S. banking organizations because the U.S. branches of non-U.S. banks do not compete, and are not in a legal position to compete, with U.S. chartered banks in the United States for retail deposits.

Shortly thereafter, the FDIC notified the IIB that it would retain the amendments to Part 347. By letter dated Jan. 19, 2010, the IIB requested additional time for uninsured U.S. branches of non-U.S. banks to come into compliance with the requirements of Part 347 and enforce the increased retail threshold only against those customers making a deposit after the end of the additional grace period.

FDIC's Final Word

By letter dated Jan. 29, 2010, the FDIC General Counsel responded, stating that it was his understanding that the reason for linking the SMDIA to the definition of "retail deposits" in the IBA was to ensure that depositors who are U.S. citizens and residents would be encouraged to place their deposits in institutions where they would benefit from the FDIC deposit insurance. Seeing this as a very important public policy objective, he saw no reason for the FDIC to exercise its statutory exemptive discretion absent a compelling reason to do so, and noted that the additional information provided by the IIB did not present such a compelling reason.

The FDIC concluded that no new deposits not in compliance with Part 347 were to be accepted after Feb. 5, 2010, and state-licensed branches must have systems and controls in place to ensure compliance not later than March 1, 2010. The FDIC deferred a decision on how it would treat nonconforming deposit accounts that were opened between Sept. 17, 2009, the date the Part 347 amendments were published, and Feb. 5, 2010, but were not in compliance with revised Part 347. As of May 7, 2010, the FDIC had not issued a public decision on this open question.

As for OCC-licensed federal branches, the OCC has not changed its regulations to match the FDIC, although it is believed that it is working on guidance, not regulations, on the issue.

Conclusion

The FDIC's linking of the "retail deposit" threshold to the SMDIA has resulted in immediate compliance costs and system revisions for non-U.S. banks, and will cause future problems for them when the SMDIA returns to $100,000 and the systems again need to be retooled to comply. In addition, after 2013, the issue then will become whether the FDIC will require state-licensed uninsured branches of non-U.S. banks to comply with periodic re-settings of the SMDIA due to the inflation adjustment requirement.

Given its position with respect to the current $250,000 threshold, one may suppose that the state-licensed uninsured branches of non-U.S. banks will be required to change their systems every time there is an inflation adjustment. Moreover, there still is the lingering inequity for state-licensed branches that the OCC has retained the $100,000 threshold for federal branches, and how and whether that will be resolved.

1. U.S. agencies of non-U.S. banks are not covered because their deposit-taking ability is strictly limited mostly to non-citizen non-residents.
2. 12 USC §3104 (b)(2005).
3. Pub. L. 102-242, Dec. 19, 1991, Title II, Subtitle A. 12 USC §3104(d).
4. The "Federal Deposit Insurance Reform Conforming Amendments Act of 2005," Pub. L. 109-173, Section 2(c)(4).
5. 12 USC §1821(a)(1).
6. Pub. L. 110-343 (Oct. 3, 2008), §136(a), 12 USC §5241(a).
7. Pub. L. 111-22 (May 20, 2009), §204(a), 12 USC §5241(a).
8. 12 CFR §211.6(a)(1). Edge and Agreement Act corporations may accept deposits from foreign governments and foreign persons and deposits from U.S. persons under very limited circumstances (such as when the funds are to be transferred outside the United States).
9. 12 CFR §215(a).
10. 12 CFR §28.16.
11. 74 Fed. Reg. 47711, Sept. 17, 2009.
12. "Standard maximum deposit insurance amount," referred to as the "SMDIA" hereafter, means $250,000 from Oct. 3, 2008, until Dec. 31, 2013. Effective Jan. 1, 2014, the SMDIA means $100,000 adjusted pursuant to subparagraph (F) of §11(a)(1) of the FDIA (12 USC 1821(a)(1)(F)). 12 CFR §347.202(v).
13. 12 USC §3104(a).
14. Gruson and Reisner, "Regulation of Foreign Banks," Fourth Edition, Volume 1, page 333, n.8.
15. 12 USC §3104(c).