

CONNELL & ANDERSEN LLP
545 FIFTH AVENUE
NEW YORK, NEW YORK 10017

WILLIAM F. CONNELL
ROY C. ANDERSEN

TELEPHONE: (212) 687-6900
FACSIMILE: (212) 687-6999
randersen@connellandersen.com

OF COUNSEL
GEORGE A. SCHNEIDER
LUCA CANTELLI

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Deposits at Branches of U.S. Banks Located in Foreign Countries

A recent proposed rule of the FDIC to state definitively that a deposit placed with a branch of an U.S. bank located in a foreign country is not eligible for deposit insurance coverage also highlighted a more subtle aspect of the treatment of deposits held at the foreign branches of U.S. banks. This treatment is not new, but it may be more significant now that the U.S. government has taken a stance that it will no longer “bail out” troubled banks in the future that are “too big to fail.”

On February 19, 2012, the FDIC published its proposed rule regarding deposits payable in branches of U.S. banks located outside the U.S. The proposed rule would clarify that deposits in these foreign branches of United States banks are not FDIC-insured deposits. This would seem to have been settled and it is unlikely that any such depositors expected to receive deposit insurance in the event of a bank closure; however, the U.K. FSA has made a proposal that may result in U.K. branches of U.S. amending their deposit agreements with customers to make deposits payable both in the U.S. and in the U.K.

In this event, the FDIC wants to amend its rules to make it clear that even such deposit agreements permitting payment in both the U.S. and in a foreign jurisdiction will not be subject to deposit insurance coverage.

The FDIC rule also contains an interesting and not obvious discussion on how a foreign deposit that is payable only in the jurisdiction where the branch is located would be treated if the home office of the foreign branch were to be liquidated. The FDIC discusses a twenty-year old Advisory Opinion to the effect that a deposit in a foreign branch of a U.S. bank would not be treated as a “deposit” for the purposes of the depositor preference rules that apply when a domestic bank is liquidated. The result of this analysis is that such deposits would NOT be preferred over general creditors in any bank liquidation and that such deposits would be paid after all deposits (both insured and uninsured, i.e., over \$250,000). Such treatment would disadvantage such deposits vis-à-vis deposits made in the U.S.

The solution to this issue would be for a depositor in a foreign branch of a U.S. bank to require that the controlling deposit agreement specify in express terms that the deposit obligation is payable in the United States. The FDIC notes that the great majority of such deposit arrangements do not provide for payment of foreign branch deposit obligations in the United States.

In the real world, the kinds of U.S. banks that have foreign branches are not likely to fail, but as seen only a few years ago, anything is possible. So even if the risks here are remote, it would seem to be an easy fix to amend account agreements to state that payment would be made at a U.S office as well. U.S. banks may not be so quick to amend transaction accounts since they are subject to reserve requirements if payable in the U.S; however nonpersonal time deposits are not subject to reserves.

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