Pratt's
Journal of Bankruptcy Law

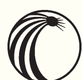
LEXISNEXIS® A.S. PRATT™ FEBRUARY/MARCH 2015

EDITOR'S NOTE: CROSS-BORDER MATTERS
Steven A. Meyerowitz

CROSS-BORDER RESOLUTION OF BANKING GROUPS: INTERNATIONAL INITIATIVES AND U.S. PERSPECTIVES—PART IV
Paul L. Lee

THE LOOMING SHADOW IN THE PRC PROPERTY MARKET
Christopher W. McFadzean and David Richardson

IF IT WALKS LIKE A DUCK ... *IN RE DUCKWORTH:*
ANOTHER WARNING TO LENDERS TO TAKE CARE IN DRAFTING SECURITY DOCUMENTS
Jeffrey Close, Mark Silverman, and Bryan Jacobson



LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D. at .... 1-800-424-0651 ext. 3207
Email: .... kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . (518) 487-3000
Fax Number . . . . (518) 487-3584
Customer Service Web site . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . (518) 487-3000

Library of Congress Card Number: 80-68780
ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] (LexisNexis A.S. Pratt);

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (LexisNexis A.S. Pratt)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2015 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt™ Publication

Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

(2015-Pub.4789)

Editor-in-Chief & Board of Editors

EDITOR-IN-CHIEF
Steven A. Meyerowitz
President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena
Bilzin Sumberg Baena Price & Axelrod LLP

Leslie A. Berkoff
Moritt Hock & Hamroff LLP

Ted A. Berkowitz
Farrell Fritz, P.C.

Michael L. Bernstein
Arnold & Porter LLP

Andrew P. Brozman
Clifford Chance US LLP

Kevin H. Buraks
Portnoff Law Associates, Ltd.

Peter S. Clark II
Reed Smith LLP

Thomas W. Coffey
Tucker Ellis & West LLP

Michael L. Cook
Schulte Roth & Zabel LLP

Mark G. Douglas
Jones Day

Timothy P. Duggan
Stark & Stark

Gregg M. Ficks
Coblentz, Patch, Duffy & Bass LLP

Mark J. Friedman
DLA Piper

Robin E. Keller
Lovells

Matthew W. Levin
Alston & Bird LLP

Patrick E. Mears
Barnes & Thornburg LLP

Alec P. Ostrow
Stevens & Lee P.C.

Deryck A. Palmer
Pillsbury Winthrop Shaw Pittman LLP

N. Theodore Zink, Jr.
Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company., Inc. Copyright 2015 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial

institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 630 Central Avenue, New Providence, NJ 07974.

Cross-Border Resolution of Banking Groups: International Initiatives and U.S. Perspectives—Part IV

Paul L. Lee*

This is the fourth part of a five-part article analyzing efforts to create effective resolution regimes for systemically important cross-border banking institutions. Parts I and II of this article discussed the promulgation of the Key Attributes of Effective Resolution Regimes for Financial Institutions by the Financial Stability Board and various national and regional efforts in the European Union aimed at implementation of the Key Attributes. Part III discussed the resolution regimes applicable to the U.S. operations of foreign banking groups and the conformance of these regimes with the Key Attributes. This Part IV discusses the resolution regime applicable to the cross-border operations of U.S. banking institutions under the Federal Deposit Insurance Act and the conformance of that regime with the Key Attributes. Part V will discuss the new resolution regime under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its application to the cross-border resolution of large U.S. banking groups.

INTRODUCTION

Ideas have consequences or so the savants say. Of all the ideas to have emerged (or re-emerged) from the 2007–2009 financial crisis, none holds the promise of greater consequences for the financial sector than that of "too big to fail." Indeed, the idea of "too big to fail" has already had significant consequences. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has imposed an enhanced prudential regime on systemically important financial institutions and created a special resolution regime for such institutions.[1] At the international level, the Financial Stability Board (the "FSB") has designated a set of global systemically important banking institutions for heightened regulation and has adopted the Key Attributes of Effective Resolution Regimes for Financial Institutions (the "Key Attributes") to promote international convergence of resolution regimes

* Paul L. Lee is of counsel at Debevoise & Plimpton LLP and a member of the firm's Financial Institutions Group. He is also a member of the adjunct faculty at Columbia Law School. Mr. Lee can be reached at pllee@debevoise.com.

[1] Dodd-Frank Act, Pub. L. No. 111-203, Titles I & II, 124 Stat. 1376, 1391–1520 (2010).

for such institutions.[2] Pursuant to a directive from the G20, the FSB has also undertaken the task of monitoring the progress that is being made at the national level in addressing "too big to fail."[3]

The savants generally agree that one of the most important measures for addressing "too big to fail" is the implementation of credible resolution regimes for systemically important financial institutions. A credible resolution regime is generally regarded as one that would permit a resolution of such an institution without destabilizing the financial system and without requiring a "bailout" of the institution by the government.[4] Part I of this article discussed the promulgation and implementation of the Key Attributes by the FSB. Part II of this article discussed national and regional efforts in the European Union aimed at creating credible resolution regimes for financial institutions. Part III of this article discussed the resolution regimes applicable to the U.S. operations of foreign banking groups and their conformance with the Key Attributes. This Part IV analyzes the resolution regime applicable to U.S. banks and their cross-border operations under the Federal Deposit Insurance Act (the "FDIA") and its conformance with the Key Attributes. Part V will analyze the new resolution regime established under Title II of the Dodd-Frank Act for systemically important financial institutions.

Since its creation in 1933, the Federal Deposit Insurance Corporation (the "FDIC") has acquired substantial experience in resolving failed banking institutions under the FDIA, although it has had only rare occasion to utilize these powers in the case of large banking institutions.[5] Title II of the

---

[2] *See* Press Release, FSB, FSB announces policy measures to address systemically important financial institutions (SIFIs) and names initial group of global SIFIs (Nov. 4, 2011), *available at* http://www.financialstabilityboard.org/wp-content/uploads/pr_111104cc.pdf; FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Oct. 15, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf.

[3] *See* FSB, *Progress and Next Steps Towards Ending "Too-Big-To-Fail,"* (Sept. 2, 2013), *available at* http://www.financialstabilityboard.org/2013/09/pr_130902/. In November 2014, the FSB provided one of its periodic reports to the G20 on the progress being made at the national level in implementing global financial reform measures, including those aimed at addressing "too big to fail." *See* FSB, *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability* (Nov. 14, 2014), *available at* http://www.financialstabilityboard.org/2014/11/fsb-reports-to-g20-brisbane-summit-on-progress-in-financial-regulatory-reforms/.

[4] For a discussion of the varying interpretations that have been attached to the phrase "too big to fail" and the effect of the varying interpretations on the analysis of resolution approaches, see George G. Kaufman, *Too big to fail in banking: What does it mean?*, 13 J. FIN. STABILITY 214 (2014).

[5] By far the largest bank ever to be resolved by the FDIC was Washington Mutual Bank in

Dodd-Frank Act is obviously of more recent vintage. It is intended to apply to the resolution of the largest and most complex U.S. financial institutions. The Title II regime is an amalgam of the specialized resolution approach taken from the FDIA with some additional creditor protections taken from the Bankruptcy Code. The Title II regime would not apply to an FDIC-insured depository institution. However, Title II would apply (in lieu of the Bankruptcy Code) to the holding company of an insured depository institution if a systemic risk determination is made with respect to the holding company.[6] As will be discussed in Part V, the FDIC is in the midst of developing an approach to implementation of the new Title II authority. This Part IV of the article discusses the challenges for cross-border resolution of FDIC-insured banking institutions under the FDIA. Part V will discuss the challenges for cross-border resolution of large U.S. banking groups under Title II.

RESOLUTION UNDER THE FDIA

The initial surveys done by the Basel Committee on Banking Supervision and the FSB in the aftermath of the financial crisis revealed significant shortcomings in the national insolvency regimes for banking institutions.[7] Many jurisdictions, including those that were home to some of the largest global banking institutions, had no specialized insolvency regime for their banking institutions and instead would have to rely on corporate bankruptcy laws to handle the resolution of a large financial institution.[8] The United

2008 with $307 billion in assets. The next largest bank to be resolved by the FDIC (through the use of "open bank" assistance) was Continental Illinois Bank and Trust Company in 1984 with approximately $40 billion in assets. For a list by asset size of the 10 largest U.S. bank failures, see James R. Barth & Apanard Prabha, *Resolving Too-Big-to-Fail Banks in the United States* 12 (March 2013) (Mercatus Center George Mason Univ. Working Paper No. 13-05), *available at* http://mercatus.org/sites/default/files/Barth_ResolvingTBTF_v1.pdf.

[6] Dodd Frank Act, Title II, § 203, 124 Stat at 1450 (2010) (codified at 12 U.S.C. § 5383).

[7] BASEL COMMITTEE, *Report and Recommendations of Cross-border Bank Resolution Group* 22–24 (Mar. 2010), *available at* http://www.bis.org/publ/bcbs169. html; FSB, *Consultative Document*, *Effective Resolution of Systematically Important Financial Institutions* 8 (July 19, 2011), *available at* http://www.financialstabilityboard.org/publications/r_110719.pdf [hereinafter *FSB Consultative Document*].

[8] *See, e.g.*, Rosalind L. Bennett, *Failure Resolution and Asset Liquidation: Results of an International Survey of Deposit Insurers*, 14 FDIC BANKING REV. No. 1, 1, 9 (2001) (an FDIC survey of foreign deposit insurance organizations indicated that a failed bank would go through a regular corporate bankruptcy process in 9 of the 15 countries designated as "advanced economies" by the IMF). *See also* Eva Hüpkes, *Insolvency—why a special regime for banks?*, *in* 3 CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW 471 (International Monetary Fund ed., 2003) (providing the arguments for the need for a special insolvency regime for banks, but noting

Kingdom, for example, entered the financial crisis with no specialized insolvency law for its banking institutions; it had only a general corporate insolvency law on its books.[9] The U.K. authorities concluded that a corporate insolvency law was ill-suited to deal with the insolvency of a major banking institution like Northern Rock and the Banking Act 2009 was thereafter enacted to provide a special resolution regime for U.K. incorporated deposit-taking institutions.[10]

The FSB has likewise concluded that corporate liquidation procedures are not well-suited to deal with the failure of major banks and other financial institutions.[11] The FSB concluded that each jurisdiction should have a special resolution regime for large financial institutions. Key Attribute 2.1 provides that each jurisdiction should have a designated administrative authority responsible for exercising resolution powers over systemically significant banking institutions.[12] The other Key Attributes identify a range of special powers (such as the power to "write down" or "bail-in" debt) that the administrative authority should have to facilitate the resolution of a financial institution.

In contrast to the case in many other jurisdictions, the United States has had a special resolution regime in place for FDIC-insured banks since the time of the creation of the federal deposit insurance system in 1933. The Banking Act of 1933 provided the initial, if rudimentary, framework for the FDIC to act as receiver for national banks and for insured state-chartered banks where permitted by state law.[13] That framework has been successively revised over the years through amendments to the FDIA to provide a relatively detailed regime

---

that a majority of European jurisdictions had nonetheless chosen to apply ordinary insolvency rules to their banks).

[9] *See* BANK OF ENGLAND, *Financial Stability Report* 65 (Oct. 2007), *available at* http://www.bankofengland.co.uk/publications/Pages/fsr/default.aspx ("One important tool that is currently unavailable in the United Kingdom is an insolvency process specifically adapted to banks.").

[10] *See* Peter Brierley, *The U.K. Special Resolution Regime for failing banks in an international context*, Bank of England Financial Stability Paper No. 5 (July 2009), *available at* http://www.bankofengland.co.uk/ publications/Documents/fsr/fs_paper05.pdf (describing the drawbacks of resolving banks using corporate insolvency laws).

[11] *FSB Consultative Document* at 8.

[12] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Oct. 15, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf [hereinafter *Key Attributes*]. In its Consultative Document, the FSB noted that the administrative authority should be able to act with necessary speed and that in those jurisdictions where a court order to initiate the process is necessary, the jurisdiction should consider any possible delay resulting from the court process in its resolution planning process. *FSB Consultative Document* at 9.

[13] Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 162 (1933).

for handling the resolution of insured depository institutions.[14] The resolution regime in the FDIA conforms with most of the Key Attributes and in fact served as a source for many of the principles reflected in the Key Attributes.[15]

As discussed in Part III of this article, the FDIA applies to the resolution of insured depository institutions to the exclusion of the Bankruptcy Code.[16] The holding company of an insured depository institution, however, is eligible for resolution under the Bankruptcy Code as are other affiliates of an insured depository institution (unless they fall into one of the other categories of entities that are excluded from eligibility under Section 109(b) of the Bankruptcy Code).[17] The initiation of a receivership proceeding under the FDIA for an insured depository institution subsidiary of a holding company is almost invariably followed by a bankruptcy filing by the parent holding company. Conflicts and challenges may arise between the interests of the FDIC as receiver for the failed depository institution subsidiary under the FDIA and the interests of the creditors and shareholders of the holding company in a bankruptcy case.[18] These disputes are typically resolved by a federal bankruptcy or a federal district court. As an overall legal matter, however, the receivership process for an insured depository institution subsidiary and the bankruptcy process for its holding company remain distinct.

Administrative vs. Judicial Process

The FDIA resolution process for an insured depository institution differs in

---

[14] The Banking Act of 1933 created the FDIC by an amendment to the Federal Reserve Act. The FDIA was enacted in 1950 to consolidate in a separate law the provisions of the Federal Reserve Act dealing with the FDIC. For a chronology of the legislative enactments that form the basis for the current receivership and resolution provisions in the FDIA, see FDIC, *Managing the Crisis: The FDIC and RTC Experience, Pt. III Appendix A—Legislation Governing the FDIC's Roles as Insurer and Receiver* (1998) [hereinafter *Managing the Crisis*].

[15] As discussed *infra*, the FDIA regime does deviate from the Key Attributes in at least one major respect. The FDIA provides for a national depositor preference, which as construed by the FDIC places foreign deposits payable only outside the United States at a significant disadvantage to domestic deposits in the event of an insolvency of an FDIC-insured bank.

[16] *Cross-Border Resolution of Banking Groups: International Initiatives and U.S. Perspectives—Part III*, 10 Pratt's Journal of Bankr. Law 291, 292–93 (2014).

[17] *Id*. If a systemic risk determination is made under Title II of the Dodd-Frank Act, the holding company would be resolved under Title II rather than under the Bankruptcy Code.

[18] The receivership proceeding for Washington Mutual Bank and the bankruptcy proceeding for its parent, Washington Mutual, Inc., offer a prime example of the kinds of challenges that can arise between such proceedings. For a high-level summary of the challenges, see FDIC, *Status of Washington Mutual Bank Receivership* (last updated Dec. 16, 2014), https://www.fdic.gov/bank/individual/failed/wamu_settlement.html.

fundamental ways from the Bankruptcy Code process for eligible corporate debtors. The first and most significant difference between the FDIA regime and the Bankruptcy Code regime is that the FDIA regime is an administrative process, not a judicial process.[19] Various advantages (and, in the eyes of some observers, disadvantages) stem from this fundamental difference.[20] In addition to this fundamental difference in process, there are significant substantive differences in the powers of the FDIC as receiver and the powers of a trustee or debtor-in-possession in bankruptcy.[21] The FDIC has summarized its views on the differences in the process and the powers between the FDIA and the Bankruptcy Code as follows:

> Although many of the concepts central to the operation of an FDIC receivership are similar to those of the bankruptcy process, federal law grants the FDIC additional powers that lead to critical differences between bankruptcy and the FDIC receivership law.
>
> . . . .
>
> These additional powers allow the FDIC to both expedite the liquidation process for banks and thrifts in order to maintain confidence in the nation's banking system and to maximize the cost-effectiveness of the receivership process to preserve a strong insurance fund. The primary advantage is that the FDIC, in administering the assets and liabilities of a failed institution as its receiver, is not subject to court supervision, and its decisions are not reviewable except under very limited circumstances.[22]

The FDIC sees its role in handling bank failures as not simply protecting insured depositors, but also minimizing the disruptive effects of bank failures

---

[19] For a detailed discussion of the differences in approach between the FDIA and the Bankruptcy Code and the rationale for the different approaches, see Richard M. Hynes & Steven D. Walt, *Why Banks are Not Allowed in Bankruptcy*, 67 WASH. & LEE L. REV. 985 (2010); Robert B. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VIRG. L. & BUS. REV. 143 (2007).

[20] For a discussion of the comparative advantages to the two approaches, see Robert R. Bliss & George G. Kaufman, *Resolving Insolvent Large Complex Financial Institutions: A Better Way*, 128 BANKING L.J. 339 (2011). For a discussion of certain of the perceived difficulties in the FDIC approach to the resolution of a large bank, see David Skeel, THE NEW FINANCIAL DEAL, UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED CONSEQUENCES) 117–127 (2011).

[21] *See* Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VIRG. L. & BUS. REV. 143 (2007).

[22] FDIC, *Resolutions Handbook* 67 (last updated April 2, 2003), *available at* https://www.fdic.gov/bank/historical/reshandbook/ch7recvr.pdf [hereinafter *Resolutions Handbook*].

and maintaining public confidence in the U.S. banking system.[23]

In the case of the failure of an insured bank, the FDIC plays two roles. First, the FDIC, in its corporate or insurer capacity, protects the depositors for the amount of their insured deposits by using one of several resolution techniques described below. Second, the FDIC acts as a receiver of the failed institution, administering the receivership estate for all creditors in accordance with the provisions of the FDIA.[24] There have historically been three principal techniques used by the FDIC to resolve a failing institution. One technique, which was used in the past but has in effect been eliminated by an amendment in the Dodd-Frank Act, was called "open bank" assistance. In an open bank assistance transaction, the FDIC in its insurer capacity could provide financial assistance to an operating bank (hence the name "open bank" assistance) and avoid the need to have the bank placed into a receivership proceeding.[25]

With the elimination of the FDIC's authority to provide open bank assistance, the resolution of a failing banking institution can now be accomplished only through the use of a receivership.[26] A receivership is commenced when the primary regulator of the bank (the Office of the Comptroller of the Currency (the "OCC") in the case of a national bank or the state chartering authority in the case of a state-chartered bank) closes the bank and appoints the

---

[23] *Id.* at 1.

[24] *Id.* at 6.

[25] For a discussion of the historical use of open bank assistance by the FDIC, see FDIC, *Managing the Crisis*, ch. 5. *See also* FDIC, *Resolutions Handbook*, ch. 5. Section 11(a)(4)(C) of the FDIA, as amended in 1993, provides that FDIC assistance may not be used in any manner to benefit a shareholder of an insured institution except pursuant to a systemic risk determination under Section 13(c)(4)(G) of the FDIA. 12 U.S.C. § 1821(a)(4)(C). This change limited the use of open bank assistance to systemically important banking institutions. Section 1106(b) of the Dodd-Frank Act amended Section 13(c)(4)(G) to provide that the systemic risk authority may only be used for an institution for which the FDIC has been appointed as a receiver. 12 U.S.C. § 1823(c)(4)(G)(i)(I). The combined effect of these provisions was to eliminate the possibility of open bank assistance in the case of an individual institution.

[26] A conservatorship is occasionally used by the FDIC as an interim step in a resolution process. As discussed *infra*, prior to an amendment made to the FDIA by the Dodd-Frank Act, the FDIC used a newly chartered federal savings association in a "pass-through" conservatorship to acquire deposits and assets from a failed savings association that had itself been placed into receivership. The FDIC used this mechanism because prior to the amendment made by the Dodd-Frank Act to the FDIA, the FDIA provided only for the chartering of a bridge bank, not a bridge savings association. With the new authority for the FDIC to charter a bridge savings association, the FDIC will not need to rely on a "pass-through" conservatorship to substitute for a bridge approach. *See infra* notes 33 & 38.

FDIC as receiver for the bank.[27] As receiver, the FDIC can use two techniques (or variations of two techniques) to resolve a failed bank. The FDIC can use an insured deposit payoff pursuant to which the FDIC as insurer pays all the insured deposits up to the limit of insurance coverage with funds from the deposit insurance fund.[28] Depositors with uninsured funds and general creditors do not receive payment from the deposit insurance fund and instead are paid on their claims only to the extent of the available assets in the receivership estate. An insured deposit payoff is generally used only for smaller banking institutions. It is neither practicable nor desirable to use an insured deposit payoff for an institution with a large number of accounts.

More commonly, the FDIC as receiver will use a second technique, called a purchase and assumption transaction, to resolve a failed bank.[29] In a purchase and assumption transaction, a healthy acquiring bank will assume the insured deposits and, in some cases, the uninsured deposits of the failed bank.[30] As part of the transaction, the acquiring bank usually pays a premium to the FDIC based on the acquirer's estimation of the value of the deposit franchise being transferred to it. The bidder's premium payment reduces the cost to the FDIC of the resolution process. In a purchase and assumption transaction, the FDIC as receiver will also transfer some or all of the assets of the failed bank to the acquiring bank. A purchase and assumption transaction minimizes the need for the FDIC to engage in what might be a lengthy and expensive liquidation

[27] 12 U.S.C. § 1821(c)(2) (appointment by the OCC); 12 U.S.C. § 1821(c)(3) (appointment by the state supervisory authority). In addition, the FDIC may appoint itself as the conservator or receiver of an insured depository institution in certain circumstances. 12 U.S.C. §§ 1821(c)(4) & (c)(10).

[28] For a discussion of the use of the insured deposit payoff technique, *see* FDIC, *Resolutions Handbook*, ch. 4.

[29] For a discussion of the reasons that the FDIC has historically preferred the use of a purchase and assumption transaction over an insured deposit payoff, see FDIC, *Managing the Crisis*, at 86–87. Recent experience confirms both the FDIC's historical preference and the bidders' current preference for the use of a purchase and assumption transaction. Since January 2010, the FDIC has used an insured depositor payoff only 15 times. During the same period it has used a purchase and assumption transaction covering both insured and uninsured deposits 327 times. *See* FDIC, *Failed Banks, Historical Statistics on Banking—Failures and Assistance Transactions*, *available at* http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30&Header=1. For an additional perspective on the use of purchase and assumption transactions, see Rosalind L. Bennett & Haluk Unal, *The Effects of Resolution-Method Choice on Resolution Costs in Bank Failures* (July 2009), *available at* www.fdic.gov/bank/analytical/cfr/2009/july/CFR_2009_bennett.pdf.

[30] For a general discussion of the use of the purchase and assumption technique, see FDIC, *Resolutions Handbook*, ch. 3 and FDIC, *Managing the Crisis*, ch. 3.

process for the individual assets of the failed bank. A purchase and assumption transaction is often less costly to the FDIC than an insured deposit payoff and straight liquidation of the assets of the failed bank by the FDIC.

A purchase and assumption transaction has the additional advantage of minimizing the disruption in services to the customers of the failed bank, who become customers of the acquiring bank in effect simultaneously with the closure of the failed bank. Under the FDIA, the FDIC as receiver can effect a purchase and assumption transaction without any approval, assignment or consent (other than an approval from the regulator with authority over the acquiring bank).[31] The technique thus has a high utility in protecting the banking system from the disruptions that would otherwise arise from a traditional liquidation process for a failed institution. A purchase and assumption transaction may involve the FDIC in its insurer capacity providing financial assistance to the acquirer, such as a level of loss protection through a so-called loss sharing arrangement on certain categories of assets acquired from the failed bank.[32] The conjunctive roles of the FDIC as insurer and the FDIC as receiver provide another feature of the FDIA resolution process that distinguishes it from the Bankruptcy Code process.

Bridge Bank Provision

There are other substantive differences between the FDIA regime and the Bankruptcy Code regime that are critical to the resolution of a large banking institution. For example, the FDIA expressly authorizes the FDIC to organize a "bridge bank" to take over both assets and liabilities of a failed bank to facilitate a more orderly resolution.[33] A bridge bank is designed to "bridge" the gap in time between the failure of the bank and the time when the FDIC as receiver can implement a satisfactory acquisition by another bank acquirer pursuant to a purchase and assumption transaction.[34] The use of a bridge bank permits continuity of banking services for customers of the failed bank as a final resolution is being developed. It provides the FDIC with additional marketing time and prospective acquirers with additional due diligence time to pursue a possible purchase and assumption transaction or, in the post-Dodd-Frank era, multiple purchase and assumption transactions for various parts of a failed bank.

---

[31] 12 U.S.C. § 1821(d)(2)(G)(i)(II).

[32] *See* FDIC, *Resolutions Handbook*, ch. 3.

[33] 12 U.S.C. § 1821(n)(1)(A). A bridge bank is chartered as a national bank by the OCC at the request of the FDIC. Based on an amendment made by the Dodd-Frank Act to the FDIA, the OCC can now also charter a bridge federal savings association at the request of the FDIC.

[34] FDIC, *Managing the Crisis* at 25–26.

The FDIA provides that the FDIC as receiver may transfer any assets or liabilities of the failed bank to the bridge bank "without any further approval under Federal or State law, assignment, or consent with respect thereto."[35] This provision assures that the transfer to the bridge bank can be done in effect simultaneously with the appointment of the FDIC as receiver for the failed bank. Equally important, the FDIA also authorizes the FDIC (in its insurer capacity) to provide financial assistance to facilitate the transfer of assets and liabilities out of the receivership of the failed bank into the bridge bank.[36] The bridge bank authority was added to the FDIA in 1987 and was used extensively by the FDIC in the late 1980s and early 1990s during the regional bank crises in Texas and New England.[37] In recent years, the FDIC has used a bridge bank mechanism only on a few occasions. The largest recent bridge bank mechanism was used by the FDIC in connection with the resolution of IndyMac Bank in July 2008.[38] IndyMac Bank had approximately $32 billion in assets at the time of its failure.

The drafters of Title II of the Dodd-Frank Act found significant merit in the bridge bank concept and incorporated it into Title II. Title II provides that the FDIC as receiver for a systemically important financial institution may organize one or more "bridge financial companies" to assume the assets and liabilities of the failed institution.[39] The provisions for a bridge financial company in Title II replicate many of the provisions for a bridge bank in the FDIA. Like the FDIA, Title II provides that any succession or assumption by a bridge financial company of the rights, powers or authorities of the failed institution shall be effective "without any further approval under Federal or State law, assignment or consent with respect thereto."[40] Another important provision in the bridge financial company provisions in Title II is the authority for the FDIC to provide funding (from a special fund created under Title II) to facilitate the

[35] 12 U.S.C. § 1821(n)(3)(A)(iv).

[36] 12 U.S.C. § 1821(n)(7). *See* FDIC, *Managing the Crisis* at 175.

[37] *See* FDIC, *Managing the Crisis* at 171–191 for a discussion of the FDIC's experience with the use of bridge banks.

[38] FDIC, Press Release, FDIC Establishes IndyMac Federal Bank, FSB as Successor to IndyMac Bank, F.S.B., Pasadena, California (July 11, 2008), *available at* http://www.fdic.gov/news/news/press/2008/pr08056.html. The IndyMac resolution did not technically involve a bridge bank under § 11(n) of the FDIA. Instead it involved the use of a "pass-through" conservatorship for a newly chartered federal savings association under § 11(d)(2)(F) of the FDIA to take over the insured deposits and certain of the assets of IndyMac. The FDIC used the "pass-through" conservatorship process as a substitute for a bridge bank.

[39] 12 U.S.C. § 5390(h)(1)(A)&(B).

[40] 12 U.S.C. § 5390(h)(2)(E)(i)&(ii).

transfer of assets and liabilities from the failed institution to the bridge financial company and to provide funding as needed to the ongoing operations of the bridge financial company.[41] This statutory funding source meets the need that must be filled by private debtor-in-possession financing in a Chapter 11 case. As the FDIC has developed its proposed approach to the authority in Title II, it has identified the use of a bridge financial company as one of the most important provisions to facilitate an orderly resolution of a systemically important financial company.[42]

The FSB has also included the mechanism of a bridge bank or bridge company in the Key Attributes. In its 2011 Consultative Document, the FSB noted that it would likely take time for a resolution authority to resolve a systemically important financial institution because of its complexity.[43] The FSB concluded that an "interim solution" such as a bridge bank or a bridge company might be needed to maintain systemically important functions while a more permanent solution is being sought.[44] The FSB has thus provided in Key Attribute 3.4 that a resolution authority should have power to establish one or more bridge institutions to take over and continue operating critical functions of a failed firm. It has also provided in Key Attribute 3.3 that a resolution authority should have the power to transfer selected assets and liabilities of a failed firm to a newly established bridge institution (or other third-party institution). Key Attribute 3.3 further provides that any transfer of assets or liabilities to a new bridge institution or other third-party institution should not require the consent of any party or creditor and should not constitute a default or termination event under any contract to which the failed institution is a party. This approach too follows the general approach in the FDIA and in Title II.

---

[41] 12 U.S.C. § 5390(h)(9). Title II provides for the establishment of an Orderly Liquidation Fund (which is separate from the deposit insurance fund under the FDIA) to be available to the FDIC to carry out its functions under Title II. 12 U.S.C. § 5390(n). Under this authority the FDIC may borrow from the Treasury subject to certain limitations. To the extent necessary to repay any such borrowing from the Treasury, the FDIC must impose assessments on financial companies with total consolidated assets of $50 billion or more. 12 U.S.C. § 5390(o).

[42] *See* FDIC, Office of Complex Financial Institutions, *Dodd-Frank Act Title II, Resolution Strategy Overview* (Jan. 25, 2012), *available at* www.fdic.gov/about/srac/2012/2012-01-25_resolution-strategy.pdf & FDIC, *Title II Resolution Strategy Overview* (Aug. 2012), *available at* www.fdic.gov/about/srac/2012/2012-01-25_resolution-strategy.pdf. *See also* FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

[43] *FSB Consultative Document* at 10.

[44] *FSB Consultative Document* at 10.

In analyzing the bridge bank power, it is important, however, to distinguish between the legal *availability* of the power and the practical *feasibility* of implementing the power. Although it is now widely accepted that a bridge bank mechanism should be available to a resolution authority, it is still undetermined whether a bridge bank mechanism could actually be implemented for a complex banking institution on a rapid enough basis (typically over a "resolution weekend") to ensure continuity of critical operations. Indeed, for a large complex bank, the answer may lie not in the use of a bridge bank, but instead in the use of a bridge financial company under Title II to resolve its parent holding company. As will be discussed further in Part V of this article, the single-point-of-entry model under Title II envisions that ideally only the top-tier holding company in a financial group would be placed into receivership under Title II.[45] Under this model, the assets of the top-tier holding company, consisting principally of the shares of its various operating subsidiaries, would immediately be transferred to a new bridge financial company. The liabilities of the top-tier holding company, consisting principally of long-term debt specifically intended to be "loss absorbing," would be left behind in the receivership proceeding. Under this model, the top-tier holding company would generally not have other business operations and would have only minimum liabilities (e.g., for taxes) other than its "loss absorbing" long-term debt.[46] The streamlined requirements for the top-tier holding company (i.e., with no operating functions and minimum operating liabilities) would facilitate a transfer to a bridge company. This admittedly stylized approach makes the bridge holding company concept more feasible in practice than the bridge bank concept for a large complex banking institution. The presence of various types of operating liabilities at a bank would complicate the process of determining which liabilities should pass to the bridge bank and which liabilities should be left behind in the receivership. Drawing distinctions among and between various types of operating liabilities and other general liabilities involves both legal and practical considerations.[47] Drawing these distinctions over a resolu-

---

[45] FDIC, *Title II Resolution Strategy Overview* (Aug. 2012), *available at* www.fdic.gov/about/srac/2012/2012-01-25_resolution-strategy.pdf.

[46] *See, e.g.,* Governor Daniel K. Tarullo, Toward Building a More Effective Resolution Regime: Progress and Challenges (Oct. 18, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20131018a.htm (discussing in the context of a single-point-of-entry strategy the desirability of keeping the parent holding company "non-operational" and otherwise "clean" through limits on the issuance of short-term debt and on the conduct of material business operations in the parent holding company).

[47] There are legal constraints on the ability of the FDIC as receiver to discriminate in the treatment of creditors in the same class. The FDIC has preserved some flexibility in this regard

tion weekend (even if foreshadowed in a living will process) for a large complex bank might well strain the capacities of the FDIC receivership staff. In fact, the single-point-of-entry model at the top-tier company level may be seen as an acknowledgment by the U.S. authorities that it might not be feasible or otherwise desirable to rely on the use of a bridge bank to assume the operations of a large complex bank. It is fortunate that the drafters of Title II modeled the bridge financial company concept in Title II on the bridge bank concept in the FDIA despite the doubts that may exist about the feasibility of the use of a bridge bank to resolve a large complex bank. Here is another example of an idea that has had consequences—in this case within the confines of the Dodd-Frank Act itself.[48]

Derivative Provisions

Another important difference between the FDIA and the Bankruptcy Code is the approach to the treatment of derivatives and other financial contracts. The FDIA contains a detailed set of provisions for the treatment of derivative and other financial contracts (collectively defined in the FDIA as "qualified financial contracts").[49] The individual definitional sections in the FDIA for what comprise "qualified financial contracts" are intended to be consistent with

---

by defining the term "administrative expenses of the receiver," as that term is used in the depositor preference provision in the FDIA, to include both "pre-failure and post-failure obligations that the receiver determines are necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the institution." 12 C.F.R. § 360.4. In adopting this interpretation of the national depositor preference provision, the FDIC explained that these expenses should be paid "to facilitate the smooth and orderly transfer of banking operations to a purchasing institution or to obtain an accounting and orderly disposition of the assets of the institution." FDIC, Receivership Rules, 58 Fed. Reg. 43069, 43070 (Aug. 13, 1993). "These expenses may include, but are not limited to, payroll, guard services, data processing, utilities, and expenses related to leased facilities." *Id*. Thus, certain operating liabilities can be accorded a priority and transferred to the bridge bank while other operating liabilities can be left behind in the receivership. Exercising this legal authority will involve an element of discretionary decision-making by the FDIC and will require prior access to adequate information about the categories of liabilities to inform the decision-making process over a resolution weekend. In addition, under Section 11(i) of the FDIA, the FDIC as receiver may distinguish among general creditors of the failed bank by transferring certain of them to the bridge bank and leaving others behind in the receivership proceeding as long as those left in the receivership proceeding receive as much as they would have received if the FDIC had not used the bridge bank. 12 U.S.C. § 1821(i). This approach too will require a complex calculation over a resolution weekend.

[48] One commentator has referred to the single-point-of-entry strategy itself as "a rare illustration of a happy unintended consequence" of the Dodd-Frank Act. David A. Skeel, Jr., *Single Point of Entry and the Bankruptcy Alternative, in* Across the Great Divide: New Perspectives on the Financial Crisis 313 (Martin N. Bailey & John B. Taylor eds., 2014).

[49] 12 U.S.C. § 1821(e)(8)(d)(i).

the corresponding definitions in the Bankruptcy Code (with the exception that the Bankruptcy Code does not include a collective definition of the contracts as "qualified financial contracts").[50] The FDIA provisions differ, however, from the Bankruptcy Code provisions in how these financial contracts are treated. The FDIA has specific provisions on the transfer of qualified financial contracts by the FDIC as receiver to a bridge bank or other thirty-party acquirer.[51] In addition, the FDIA imposes a one-business-day stay on the exercise by a counterparty of any right to terminate, liquidate or net a qualified financial contract "solely by reason of or incidental to the appointment of a receiver for the depository institution (or the insolvency or financial condition of the depository institution for which the receiver has been appointed)."[52] This stay remains in effect until 5:00 p.m. (Eastern time) on the business day following the day of the appointment of the receiver (or the counterparty has received notice that the contract has been transferred by the receiver under the specific transfer provisions for qualified financial contracts in the FDIA). This provision is designed to provide the FDIC as receiver with time to arrange a possible transfer of the book of qualified financial contracts of the failed bank to a bridge bank or perhaps even a third-party acquirer, ideally over a "resolution weekend."[53]

The temporary stay provision in the FDIA differs significantly from the approach in the Bankruptcy Code. The relevant provisions in the Bankruptcy Code expressly exclude the defined categories of financial contracts from the automatic stay (and certain other provisions such as the preference provisions) in the Bankruptcy Code.[54] These so-called "safe harbor" provisions in the Bankruptcy Code have come under intense scrutiny after the Lehman Brothers bankruptcy. Various commentators have proposed that the Bankruptcy Code "safe harbor" approach to derivatives and other financial contracts should be

---

[50] *See* H.R. Rep. No. 109-31, pt. 1, at 119 (2005).

[51] Section 11(e)(9) of the FDIA provides that in any transfer of assets or liabilities of a failed bank, the FDIC as receiver may not "cherry pick" among the qualified financial contracts between the bank and any individual counterparty. If any qualified financial contract with an individual counterparty is to be transferred, all qualified financial contracts with this counterparty must be transferred to the same party. 12 U.S.C. § 1821(e)(9). Likewise, the FDIC as receiver may not "cherry pick" in deciding whether to affirm or disaffirm qualified financial contracts between the bank and any individual counterparty or affiliate of that counterparty. 12 U.S.C. § 1821(e)(11).

[52] 12 U.S.C. § 1821(e)(10)(B).

[53] *See* H.R. Rep. No. 109-31, pt. 1, at 124 (2005).

[54] *See* 11 U.S.C. §§ 362(b)(6), (7), (17) & (27); 555, 556, 559, 560 & 561. *See also* 11 U.S.C. §§ 546(e), (f), (g) & (j) & 548(d)(2).

revisited, particularly as applied to systemically important financial institutions.[55] Public policymakers and regulators have suggested that the financial industry should itself attempt to remedy the problem as a contractual matter by revising standard form industry documents to incorporate a temporary stay on certain early termination rights.[56]

The International Swaps and Derivatives Association, Inc. ("ISDA") announced in October 2014 that 18 major banks have agreed to enter into a new ISDA Resolution Stay Protocol (the "Stay Protocol"), which was developed in coordination with the FSB to support cross-border resolutions.[57] Section 1 of the Stay Protocol provides for the adhering parties to "opt in" to the statutory stay provisions in the special resolution regimes in six initial jurisdictions. The special resolution regimes covered by Section 1 are those of the United States (including the FDIA and Title II), the United Kingdom Germany, Switzerland, Japan and France.[58] The length of the stay and applicable creditor protections are in each case as specified in the individual special resolution regime. Section 2 of the Stay Protocol is designed to provide a temporary stay of termination rights for cross-defaults resulting from affiliate insolvency proceedings under U.S. resolution regimes, including the Bankruptcy Code and the FDIA. Under Section 2, parties adhering to the Stay Protocol agree to a stay on cross-default rights for the longer of one business day and 48 hours, provided that certain creditor protection provisions are satisfied.[59] Section 2 has the effect of extending by contract the stay of cross-default rights contained in Title II (discussed below) to proceedings under the FDIA and the Bankruptcy Code.

---

[55] *See*, *e.g.*, Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailout?*, 35 J. Corp. Law 469 (2010); Stephen J. Lubben, *Repeal the Safe Harbors*, 18 AM. Bankr. Inst. L. Rev. 319 (2010); Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 Stan. L. Rev. 539 (2011); Darrell Duffie & David A. Skeel, *A Dialogue on the Costs and Benefits of Automatic Stays for Derivatives and Repurchase Agreements*, in Bankruptcy Not Bailout: A Special Chapter 14 (Kenneth E. Scott & John B. Taylor eds., 2012).

[56] *See* Press Release, FDIC, Federal Deposit Insurance Corporation, Bank of England, German Federal Financial Supervisory Authority and Swiss Financial Market Supervisory Authority Call for Uniform Derivatives Contracts Language (Nov. 5, 2013), *available at* http://www.fdic.gov/news/news/press/2013/prl3099.html.

[57] Press Release, ISDA, Major Banks Agree to Sign ISDA Resolution Stay Protocol (Oct. 11, 2014), *available at* http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol.

[58] ISDA, *ISDA 2014 Resolution Stay Protocol* (Nov. 4, 2014), *available at* http://assets.isda.org/media/f253b540-25/958e4aed.pdf.

[59] *See* FDIC Systemic Resolution Advisory Committee Meeting, Presentation on ISDA Protocol (Dec. 10, 2014), *available at* https://www.fdic.gov/about/srac/2014/2014_12_10_presentation_orderly-liquidation.pdf.

Section 1 took effect for the initial 18 adhering banks on January 1, 2015. Section 2 will take effect on the effective date of national regulations requiring global systemically important banks to amend their over-the-counter derivatives contracts to conform to the Stay Protocol.[60]

Title II follows the approach in the FDIA for the treatment of qualified financial contracts rather than the approach in the Bankruptcy Code. In fact, the Title II provisions represent an enhancement of the stay protections over those in the FDIA. Title II includes a provision for a temporary stay on certain close-out rights on qualified financial contracts that is identical to the stay provision in the FDIA.[61] But Title II also includes a broader provision relating to contracts that are guaranteed or otherwise supported or linked to the company (referred to as a "covered financial company") that is placed into a resolution proceeding under Title II. This provision states that the FDIC as receiver for a covered financial company has the power to enforce contracts of subsidiaries or affiliates of the covered financial company, the obligations of which are guaranteed, supported or linked to the covered financial company, notwithstanding any contractual right to terminate, liquidate or accelerate such contracts (i) if the guaranty or other support and related assets and liabilities are transferred to and assumed by a bridge financial company or other third party within the same period of time covered by the stay on the close-out rights on qualified financial contracts, or (ii) if the FDIC as receiver otherwise provides adequate protection with respect to the obligations.[62] This provision is designed to address the concern about cross-default rights in these contracts that would otherwise permit the close-out and liquidation of such contracts. The potential exercise of such cross-default rights is thought to be disruptive to an orderly resolution process and to present a systemic risk of a fire sale of collateral by numerous counterparties. This additional provision in Title II is an important expansion of the stay power in the FDIA. As noted above, the Stay Protocol would by contract extend this stay on cross-defaults to the FDIA and the Bankruptcy Code.

The FSB too recognized the need for a temporary stay of certain contractual acceleration, termination and close-out rights on financial contracts in developing the Key Attributes. As the FSB noted in its Consultative Document, early termination rights on financial contracts could result in the liquidation of

---

[60] *Id.*

[61] 12 U.S.C. § 5390(c)(10)(B).

[62] 12 U.S.C. § 5390(c)(16).

collateral at fire-sale prices, destabilizing the markets.[63] In addition, the exercise of early termination rights could frustrate the implementation of resolution measures, such as the transfer of critical operations from a failed bank to a bridge bank.[64] As the FSB also noted in its Consultative Document, the availability of temporary liquidity funding through the resolution regime may be necessary to provide assurance that the bridge bank will be able to perform its obligations on the transferred contracts.[65] Accordingly, Key Attribute 4.2 provides that entry into resolution or the exercise of any resolution powers should not trigger statutory or contractual set-off rights or early termination rights if the substantive obligations under the financial contract continue to be performed.[66] Key Attribute 4.3 provides that if contractual early termination rights are nevertheless exercisable, the resolution authority should have the power to stay such rights temporarily if they arise only by reason of entry into resolution or the exercise of any resolution power.[67] This stay would be limited in time, e.g., for a period not to exceed two business days, and it would not apply to termination rights based on a performance default under the contract, e.g., a failure to make a payment or to deliver or return collateral. The temporary stay provisions in the FDIA and in Title II are generally in conformance with the Key Attributes.

Depositor Preference Provision

There are other substantive differences between the FDIA and the Bankruptcy Code, such as, on the one hand, the broader authority under the FDIA for the FDIC as receiver to repudiate contracts and, on the other hand, the narrower authority under the FDIA for the FDIC as receiver to challenge pre insolvency transfers.[68] From the perspective of this article, however, there is one other difference that is of singular importance in the resolution of the cross-border operations of a U.S. bank. This other difference is the provision in the FDIA creating a so-called "national depositor preference," i.e., a statutory liquidation priority for deposit claims.[69] The depositor preference provision in

---

[63] *FSB Consultative Document* at 21–22.

[64] *FSB Consultative Document* at 21–22.

[65] *FSB Consultative Document* at 72–73.

[66] *Key Attribute* 4.2.

[67] *Key Attribute* 4.3.

[68] *See* Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 Virg. L. & Bus. Rev. 143 (2007) for a discussion of these differences between the FDIA and the Bankruptcy Code.

[69] 12 U.S.C. § 1821(d)(11)(A). The reference to a "national" depositor preference is misleading. The word "national" should not be read to be in contrast to the word "foreign."

the FDIA provides the following order of priority for payment of unsecured claims in liquidation: first, administrative expenses of the receiver; second, any "deposit liability"; third, any other general or senior liability; fourth, any obligation subordinated to depositors or general creditors; fifth, any claims of shareholders. The effect of the depositor preference provision is to place all claims on a "deposit liability" (as that term is construed by the FDIC), including the uninsured amount of any deposit claim, ahead of all general unsecured creditors, thereby significantly reducing the possibility of any recovery on these latter claims.[70] This statutory subordination of general creditor claims to depositor claims was intended to reduce the cost to the FDIC and the deposit insurance fund of resolving insured institutions. Prior to the addition of the depositor preference provision, deposit claims (including the claims of the FDIC as subrogee on the insured portion of deposit claims) shared *pari passu* with general creditor claims (absent a contrary state depositor preference law for a state bank). The effect of the depositor preference provision is to provide another level of loss absorbency (in addition to the loss absorbency provided by any contractually subordinated claims and shareholder claims) before a loss is incurred by any deposit claim.[71]

The FDIC has interpreted the phrase "deposit liability" in the depositor preference provision in the FDIA to encompass only a deposit payable in the United States.[72] For various regulatory and legal reasons, it has generally been

---

Instead, it should be read to be in contrast to the word "state." At the time of the addition of the "national" depositor preference to the FDIA, 30 states had depositor preference provisions in their own laws. The purpose of the national depositor preference provision was to create a national rule. *See* FDIC Advisory Opinion 94-1 (Feb. 28, 1994).

[70] FDIC, *Managing the Crisis*, at 45. It was clearly understood at the time of the enactment that the depositor preference provision would have a significant effect on recoveries for non-depositor claims. *See* H.R. Rep. No. 103-11, at 95 (1993) ("As a result of this depositor preference, creditors who are not depositors are unlikely to recover any of their claims on failed institutions.").

[71] *See* James A. Marino & Rosalind L. Bennett, *The Consequences of National Depositor Preference*, 12 FDIC BANKING REVIEW NO. 2, 19 (1999). As Marino and Bennett note, the national depositor preference provision has a potentially greater effect on large banks because they typically have substantial amounts of foreign deposits and other unsecured general liabilities. One of the effects of the depositor preference provision could be to facilitate the use of a purchase and assumption transaction covering both insured and domestic uninsured deposits for such banks. *Id.* at 19 & 22. For an additional discussion of the effect of the depositor preference provision on general creditor claims, *see* Christopher T. Curtis, *The Status of Foreign Deposits under the Federal Depositor—Preference Law*, 21 U. PA. J. INT'L ECON. L. 237 (2000).

[72] *See* Deposit Insurance Regulations; Definition of Insured Deposit, 78 Fed. Reg. 11,604 (Feb. 19, 2013). The original FDIC interpretation was issued in 1994. FDIC Advisory Opinion 94-1, Letter of Acting General Counsel Douglas H. Jones (Feb. 28, 1994). *See also* Federal

the practice of U.S. banks to specify in their deposit documentation that a deposit taken at a foreign branch is payable only at the foreign branch.[73] Under the FDIC's interpretation of the depositor preference provision, such foreign deposits would not be entitled to the depositor preference. This means that the foreign deposit claims would be subordinated to domestic deposit claims and would serve along with all other general creditor claims as another layer of loss absorbency for domestic deposit claims. This outcome is severely adverse to the position of foreign depositors in the event of the failure of a FDIC-insured bank.

Although this interpretation of the depositor preference provision has been espoused by the FDIC since as early as 1994, it gained renewed prominence in September 2012 when the U.K. Financial Services Authority (the "FSA") issued a Consultation Paper on the implications of national depositor preference regimes for foreign branches operating in the U.K.[74] The Consultation Paper suggested that the FSA might restrict firms from non-European Economic Area countries with national depositor preference regimes from accepting deposits in

---

Reserve Board, Division of Banking Supervision and Regulation, Supervisory Letter SR 94-49 (IB) (Sept. 2, 1994). The FDIC Advisory Opinion concluded that the term "deposit liability" should be defined by reference to the definition of the term "deposit" in Section 3(l) of the FDIA. Section 3(l)(5) excludes from the definition of "deposit" any obligation payable only outside the United States and its territories. 12 U.S.C. § 1813(l)(5)(A). Section 3(l)(5) also excludes from the definition of "deposit" any international banking facility deposit as that term is defined from time to time by the Federal Reserve Board. 12 U.S.C. § 1813(l)(5)(B). An international banking facility is in effect a segregated set of books and records maintained by a bank in the United States that is treated for certain regulatory and tax purposes as if it were a foreign branch. It is generally permitted to take deposits only from residents of foreign countries. Based on the theory in the FDIC Advisory Opinion, a deposit booked in an international banking facility also would not be entitled to treatment as a "deposit liability" for purposes of the depositor preference provision.

[73] *See* Letter from Wayne A. Abernathy, Executive Vice President, American Bankers Association, & Cecelia Calaby, Executive Director and General Counsel, ABA Securities Association, to Robert E. Feldman, Executive Secretary, FDIC (April 19, 2013), *available at* https://www.fdic.gov/regulations/laws/federal/2013/2013-ae00-c_03.pdf (discussing the reasons why U.S. banks have refrained from making deposits at foreign branches dually payable in the United States, including sovereign risk considerations and potential reserve requirements under Regulation D of the Federal Reserve Board). Another reason in the past for a bank making its foreign deposits payable only outside the United States was that a deposit payable outside the United States was not subject to an FDIC insurance assessment. *See* 78 Fed. Reg. at 11,605. This particular motivation was removed by a provision in the Dodd-Frank Act that effectively makes foreign deposits subject to insurance assessments on the same basis as domestic deposits. *See* Dodd-Frank Act, § 331(b) (codified at 12 U.S.C. § 1817 (note)).

[74] Financial Services Authority, *Consultation Paper CP 12/23: Addressing the implications of Non-EEA national depositor preference regimes* (Sept. 2012), *available at* http://www.fsa.gov.uk/static/pubs/cp/cp12-23.pdf.

the U.K. unless arrangements were made to ensure that the U.K. depositors would be no worse off than the depositors in the home country if the firm were to fail. The Consultation Paper noted that the FSB itself had highlighted the issue of national depositor preference laws in its work on the Key Attributes.[75] Key Attribute 7.4 provides that national laws and regulations should not discriminate against creditors on the basis of their nationality, location of their claim, or the jurisdiction where it is payable.[76] The FDIA depositor preference provision, as construed by the FDIC, is in direct conflict with Key Attribute 7.4.

In response to the FSA Consultation Paper, the FDIC sought to achieve an indirect solution for the depositor preference problem identified by the FSA. In September 2013, the FDIC amended its insurance regulations to clarify that a deposit carried on the books of a foreign branch would not be entitled to insurance coverage under the FDIA even if it were also made payable at an office in the United States.[77] Based on this amendment to its insurance regulations, the FDIC concluded that U.S. banks could choose to make deposits carried on the books of foreign branches payable both at the foreign branch and at an office in the United States.[78] With such "dual payability," a foreign deposit would meet the FDIC's interpretation of "deposit liability" in the FDIA depositor preference provision, but would not in the view of the FDIC expose the FDIC for insurance coverage of the foreign deposit. The FDIC chose the approach of encouraging "dual payability" of foreign deposits over another approach suggested by certain commenters. Those commenters suggested that the better approach would be for the FDIC to revisit its prior interpretation of the FDIA depositor preference provision and issue a new interpretation or regulation that extends the benefit of the depositor preference provision to foreign deposits even if they are not payable at a location in the United States.[79] The FDIC's approach has not resolved the concern with the FDIA depositor preference provision. There are practical, operational and legal issues that may still be presented by the suggested solution of making foreign

---

[75] *Id.*

[76] *Key Attribute* 7.4.

[77] *See* Deposit Insurance Regulations; Definition of Insured Deposit, 78 Fed. Reg. 56,583, 56,584 (Sept. 13, 2013).

[78] *Id.*

[79] *See* Letter from Wayne A. Abernathy, Executive Vice President, American Bankers Association, & Cecelia Calaby, Executive Director and General Counsel, ABA Securities Association, to Robert E. Feldman, Executive Secretary, FDIC (April 19, 2013), *available at* https://www.fdic.gov/regulations/laws/federal/2013/2013-ae00-c_03.pdf.

deposits payable both at the foreign branch and in the United States.[80] The Bank of England has not yet taken action based on the issues identified in the FSA Consultation Paper. It is not clear whether the approach adopted by the FDIC will fully satisfy the concerns reflected in the FSA Consultation Paper. The failure to reach a satisfactory solution to the treatment of foreign deposits under the depositor preference provision will, as discussed further below, present significant issues for U.S. banks with foreign branches and for foreign regulatory authorities, including foreign deposit insurance authorities that face the prospect of a subordinated position on their subrogated claims.

FDIC EXPERIENCE WITH FOREIGN BRANCHES

A prominent consideration in any cross-border resolution of a U.S. banking institution will necessarily be the handling of its foreign branches. There are at least two interrelated perspectives from which this question must be considered. First, what approach would the FDIC take to the resolution of a foreign branch? The answer to this question will be provided by the FDIA. Second, what approach would the host authority take to the resolution of a branch of a U.S. banking institution operating in the host jurisdiction? The answer to this question will be provided by the host country laws to the extent that they make provision for a resolution process for a foreign branch. The FSB's Key Attribute 1.1 provides that a national resolution regime should extend to the branches of foreign firms operating in the national jurisdiction.[81] It is not clear, however, how prevalent this practice is in national resolution regimes. The recently adopted European Union Bank Recovery and Resolution Directive (the "BRRD") provides an answer for the Member States of the European Union. The BRRD generally provides for recognition of a third country (i.e., a non-Member State) resolution proceedings for branches operating in a Member State, subject to certain exceptions.[82] The principal exceptions to the recognition rule are for third-country resolution proceedings that would have adverse effects on the financial stability in the Member State and for third-country resolution proceedings where creditors or depositors located in the Member State would not receive the same treatment as third-country creditors or depositors with similar legal rights in the third-country home resolution proceeding.[83] The latter exception is intended to address national depositor

---

[80] *See id.*

[81] *Key Attribute* 1.1.

[82] Directive 2014/49/EU of the European Parliament and of the Council of 15 May 2014, art. 94, O.J. L. 173/190 (2014).

[83] *Id.*, art. 95.

preference or other discriminatory measures in the third-country resolution regime. If one of the exceptions were to be applicable, a Member State would be entitled to take independent action with respect to the branch rather than defer to the home country resolution process. Such an approach might well involve a ring-fencing outcome.

Franklin National Bank—An Early Case

Notwithstanding the fact that the FDIC has had extensive experience in the resolution of insured banks, it has had relatively little experience in the resolution of insured banks with foreign branches. It appears that the FDIC's earliest experience with the resolution of a bank with foreign branches came with the failure of Franklin National Bank ("FNB") in 1974.[84] At the time, the U.S. authorities described FNB as the largest and most complex bank failure in U.S. history.[85] Size and complexity are surely relative terms. When it failed on October 8, 1974, FNB had approximately $3.6 billion in assets and 104 branches, including two foreign branches in London and in Nassau in the Bahamas.[86] The case of FNB was nonetheless extraordinary for its time. Of its $3.6 billion in assets, nearly one-fifth were booked in its two foreign branches.[87] More extraordinary still, as of October 8, 1974, FNB had outstanding advances from the Federal Reserve discount window of approximately $1.7 billion, representing nearly half of all its liabilities.[88] From May 8, 1974 (when the Federal Reserve Bank of New York opened the discount window to FNB) through October 8, 1974 (when FNB was placed into receivership), the London and Nassau branches lost over 75 percent of their deposit funding.[89] The advances from the discount window were used to cover the shortfall in funding of FNB's foreign branches as well as the shortfall in funding of FNB's domestic operations. This was the first time that the discount

---

[84] *See* JOAN E. SPERO, THE FAILURE OF THE FRANKLIN NATIONAL BANK, CHALLENGE TO THE INTERNATIONAL BANKING SYSTEM 130 (Columbia University Press 1980) [hereinafter SPERO].

[85] *See* James H. Oltman, *Failing Banks—The Role of the Fed*, 27 ADMIN. L. REV. 317, 323 (1975) ("The supervisory authorities simply had no experience with a potential bank failure of the magnitude and complexity of Franklin."). *See also* FDIC, *The First Fifty Years, A History of the FDIC 1933–1983* 91 (1984) (noting that at the time Franklin National Bank was the largest bank failure in U.S. history).

[86] *See* Andrew F. Brimmer, *The Federal Reserve and the Failure of Franklin National Bank: A Case Study of Regulation*, in BUSINESS AND THE AMERICAN ECONOMY, 1976–2001, at 109 (Jules Backman ed., 1976) [hereinafter Brimmer].

[87] *See id.* at 110.

[88] *See* SPERO at 129.

[89] *See* SPERO at 128.

window was used to cover outflows at a foreign branch of a U.S. bank.[90] Although the U.S. authorities did not use the phrase "systemic risk" to describe the situation at FNB, it is clear that they were concerned with the effects that a disorderly failure of FNB would have on the national and international markets, exposing domestic and foreign banks to funding difficulties and losses.[91] In fact, so concerned were the U.S. authorities with the potential effects on the national and international markets that the Federal Reserve Board publicly announced at the outset of FNB's funding troubles that it was opening the discount window to FNB.[92]

In addition to the concern about the losses that would be imposed on parties that had extended Eurodollar funding to FNB's London and Nassau branches, there was equal concern with the exposure that FNB had created for itself and for its counterparties by writing a large volume of foreign exchange forward contracts.[93] This large foreign exchange exposure of $725 million for FNB came at the same time that the German Bankhaus I.D. Herstatt failed in June 1974 from foreign exchange losses, placing even greater pressure on the foreign exchange markets. Because none of the prospective acquirers of FNB's operations was willing to take the risk on FNB's forward commitments, the Federal Reserve Bank of New York, in September 1974, was forced to assume the open foreign exchange positions under a set of contractual arrangements among the FDIC, the Federal Reserve Bank of New York and FNB.[94] This extraordinary step too was taken by the Federal Reserve Bank of New York out of concern for the financial stability of the international markets.[95]

---

[90] *See* Spero at 129.

[91] *See* Brimmer at 118 ("Th[e] fact [that one-fifth of Franklin National Bank's total business was related to the Euro-dollar market] assumed enormous importance in the Federal Reserve's efforts to cope with the host of problems generated by Franklin's foundering during the summer of 1974.").

[92] *See* Brimmer at 128 (quoting the public statement issued by the Federal Reserve Board on May 12, 1974 indicating that the Federal Reserve System stood ready to advance funds to Franklin National Bank as needed).

[93] *See* Brimmer at 110.

[94] *See* Spero at 133–134.

[95] *See* Spero at 134–136. *See also* Brimmer at 110 ("Both of these developments [extending extraordinary credit from the discount window and taking over the foreign exchange forward position of Franklin National Bank] represent an extension of central bank responsibilities beyond the boundaries traditionally conceived."). Some commentators were critical of the actions taken by the Federal Reserve System. *See, e.g.,* Anna Schwartz, *The Misuse of the Fed's Discount Window*, 74 Fed. Res. Bank of St. Louis Review 58, 63 & 64 (1992) ("In 1974 the Federal Reserve behaved contrary to traditional principles when uninsured depositors started a run on

When FNB was placed into receivership on October 8, 1974, the FDIC as receiver immediately transferred all the deposits and certain other liabilities and assets of FNB to European-American Bank and Trust Company ("EAB") under a purchase and assumption agreement. EAB assumed both the domestic deposits and the foreign deposits of FNB. The U.S. authorities wanted EAB to assume FNB's foreign deposits to reassure the Eurodollar market (an important funding source for many other large U.S. banks).[96] In the FDIC's initial analysis of the proposed transfer of the London branch of FNB to a potential bank acquirer, certain issues were identified under English law. It appeared that a separate liquidation proceeding for the London branch might be necessary under English law and that certain foreign exchange and other approvals would be needed, which could delay the transfer of the London branch by the FDIC to an acquirer.[97] After consultation between the senior leadership of the FDIC and the Bank of England, it was concluded that a separate liquidation proceeding for the London branch would not be necessary and that the other approvals required under English law could be issued by the Bank of England immediately upon the appointment of the FDIC as receiver for FNB.[98] The path was thus cleared for a transfer of the London branch assets and deposits to EAB immediately upon the appointment of the FDIC as receiver for FNB. Cooperation in this particular instance between the FDIC and the Bank of England was undoubtedly facilitated by the fact that the depositors of FNB's London branch would be fully protected in the FDIC's resolution process. The FNB case represents an early precedent for a resolution of foreign branches that recognizes the interests of the host jurisdiction and the international markets.[99]

In subsequent resolutions of other insured banks, the FDIC also provided protection to foreign depositors. In some cases, this protection was a function of the resolution mechanism chosen. Open bank assistance, for example, necessarily involved providing protection to all creditors and uninsured depositors. The open bank assistance provided to Continental Illinois National Bank and Trust Company ("Continental Illinois") in 1984 is perhaps the most

---

Franklin National Bank after news surfaced that it had large foreign exchange losses.") & ("The bank [Franklin National Bank] was insolvent when its borrowing [from the Federal Reserve System] began and insolvent when its borrowing ended.").

[96] *See* Spero at 138.

[97] *See id.* at 151.

[98] *See id.* at 152.

[99] *Cf.* Brimmer at 136 ("So, we can see growing out of the Franklin National episode recognition by the Federal Reserve System of a new dimension in the responsibilities of central banks. This was the clear and explicit acceptance of the use of central bank resources to help stabilize money markets beyond its own boundaries.").

prominent example of the use of open bank assistance to protect uninsured depositors and general creditors.[100] In the case of Continental Illinois, protecting the foreign deposit base was actually one of the principal objectives of the open bank assistance program. More than 40 percent of Continental Illinois' liabilities consisted of foreign deposits.[101] It was foreign depositors who began a "high-speed electronic run" on Continental Illinois in May 1984, precipitating a funding crisis for Continental Illinois and the FDIC intervention.[102] Protecting the foreign deposit base from further runs was an essential purpose of the FDIC intervention, which included an initial FDIC public statement that all depositors and creditors would be fully protected.[103]

Other banks that were resolved through open bank assistance also had foreign depositors.[104] In at least a few instances, foreign depositors were also protected in closed bank resolutions. For example, when the FDIC resolved the Bank of New England in January 1991, it used a bridge bank as an interim step. The FDIC as receiver transferred all the deposits, both insured and uninsured, and most of the other liabilities and assets of the Bank of New England to the bridge bank.[105] The Bank of New England had a relatively small foreign deposit base of approximately $100 million in its Cayman Islands branch.[106] The Bank of New England also had foreign exchange, interest rate swaps and other qualified financial contracts outstanding. These too were transferred to the

---

[100] For a discussion of the FDIC resolution of Continental Illinois, see FDIC, *Managing the Crisis, Part II, Case Studies of Significant Bank Resolutions*, ch. 4: Continental Illinois National Bank and Trust Company.

[101] *See* FDIC, *History of the 80s, Vol. 1: An Examination of the Banking Crisis of the 1980s and Early 1990s,* ch. 7: Continental Illinois and "Too Big to Fail," at 255.

[102] FDIC, *Managing the Crisis*, at 547–548. As discussed *infra*, the speed and scope of a run by foreign depositors on a troubled bank would be even greater today than at the time of Continental Illinois because of the addition of the national depositor preference provision to the FDIA in 1993.

[103] *Id.* at 548–549.

[104] First Pennsylvania Bank had over $2 billion in foreign deposits when it received open bank assistance in 1980. Similarly, the bank subsidiaries of First Republic Bancorporation and First City Bancorporation had $900 million and $138 million in foreign deposits, respectively, when they received open bank assistance in 1988. The bank subsidiaries of First Republic Bancorporation and First City Bancorporation subsequently underwent a closed bank resolution process. *See* FDIC, *Managing the Crisis*, at 515–524, 567–593, & 595–615. *See* 137 Cong. Rec. S16903-04 (Nov. 18, 1991) (statement of Sen. Sasser providing the figures for the foreign deposits in each of these cases). *See also* S. Rep. No. 102-167, at 44–49 (1991) (discussing other instances of foreign depositors being protected in FDIC resolutions).

[105] FDIC, *Managing the Crisis,* at 635–639.

[106] *See* 137 Cong. Rec. S16903-04 (Nov. 18, 1991 (statement of Sen. Sasser).

bridge bank.[107] These depositors and counterparties became the beneficiaries of the bridge bank mechanism used by the FDIC. The Bank of New England case, however, was the last one in which the FDIC would enjoy such broad latitude in protecting foreign deposits, particularly through the use of a bridge bank mechanism. Subsequent changes to the FDIA have limited the broad flexibility that the FDIC had previously enjoyed in shaping resolutions to protect foreign deposits.

Legislative Changes to the FDIA

Legislative changes made to the FDIA in 1991 and 1993 significantly affected the FDIC process for dealing with failing banks. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") made several key changes to the FDIC resolution process. The first and most significant change was the addition of a "least-cost" resolution requirement to the FDIA. The least-cost requirement codified in Section 13(c)(4)(A)(ii) of the FDIA provides that the total amount of expenditures and obligations incurred by the FDIC in a proposed resolution of an insured bank must be the least costly to the deposit insurance fund of all possible methods for meeting the FDIC's obligation to provide insurance coverage for the insured deposits of the institution.[108] This provision was intended to constrain the practice of the FDIC of regularly providing protection to uninsured depositors, including in particular foreign depositors.[109]

There is, however, an important exception to the least-cost resolution requirement, the so-called systemic risk exception contained in subparagraph

---

[107] *See* FDIC Statement on Bank of New England (Jan. 7, 1991), *available at* http://www.nytimes.com/1991/01/07/business/fdic-statement-on-bank-of-new-england.html. *See also* Craig Torres, *Dangerous Deals: How Financial Squeeze Was Narrowly Avoided In 'Derivatives Trade'—Bank of New England's Woes Battled Currency Markets As Its Credit Evaporated—A Hazard That Could Return*, Wall St. J., June 18, 1991.

[108] 12 U.S.C. § 1823(c)(4)(A)(ii), as added by § 141(a)(1) of Pub. L. 102 242 (1991). The total amount of expenditures and obligations incurred includes immediate and long-term obligations of the FDIC and any direct or contingent liability for future payment. The FDIC is required to evaluate the alternatives on a present-value basis using a realistic discount rate. *Id.*

[109] The legislative history of the FDICIA least-cost requirement reflects a general concern with the protection provided to uninsured depositors and a specific concern with the protection provided to foreign depositors. *See* S. Rep. No. 102-167, at 44–49 (1991). In the floor debate, a number of Senators expressed concern about the FDIC practice of protecting foreign deposits because at that time no insurance premiums were assessed on foreign deposits. *See, e.g.*, 137 Cong. Rec. S16903-04 (Nov. 18, 1991) (statement of Sen. Sasser) & 137 Cong. Rec. S16906 (Nov. 18, 1991) (statement of Sen. Conrad).

(G)(i) of Sections 13(c)(4).[110] The systemic risk exception in Section 13(c)(4)(G)(i) provides that upon a recommendation by a vote of no less than two-thirds of the members of the FDIC Board and two-thirds of the members of the Federal Reserve Board, the Secretary of the Treasury, in consultation with the President, may determine that compliance by the FDIC with the least-cost requirement would have "serious adverse effects on economic conditions or financial stability," and that other action or assistance by the FDIC (including providing protection to uninsured depositors and general creditors) would avoid or mitigate such adverse effects.[111] In the case of such a determination, the FDIC can provide protection to uninsured depositors and general creditors even if providing such protection imposes costs on the deposit insurance fund beyond those necessary to cover only the insured deposits.[112]

FDICIA also added in subparagraph (E) of Section 13(c)(4) a requirement that the FDIC not take any action that has the effect of increasing losses to the deposit insurance fund by protecting depositors for more than the insured portion of their deposits or by protecting creditors other than depositors.[113] But like the general least-cost requirement, this requirement was made subject to an exception to allow an acquirer in a purchase and assumption transaction to acquire uninsured deposit liabilities so long as the deposit insurance fund does not incur any loss with respect to those liabilities greater than it would have incurred with respect to such liabilities if the institution had been liquidated.[114] The FDIC has read the requirement in subparagraph (E) of Section 13(c)(4) to be subsumed in the more general least-cost requirement in subparagraph (A) of Section 13(c)(4) and to have no independent operative effect.[115]

In addition to the least-cost requirement, FDICIA also added a new Section

---

[110] 12 U.S.C. § 1823(c)(4)(G)(i), as added by § 141(a)(1) of Pub. L. 102-242 (1991).

[111] The process for invoking the Orderly Liquidation Authority in Title II of the Dodd-Frank Act (12 U.S.C. § 5383(a)) was modeled upon the systemic risk provisions in the FDIA.

[112] The original FDICIA amendment provided that the FDIC was to recover any loss to the deposit insurance fund arising from assistance given under the systemic risk exception through one or more special assessments on insured depository institutions (based on average total assets of the institution). In 2009, the assessment provision was revised to provide for one or more special assessments on insured depository institutions, depository institution holding companies (with the concurrence of the Secretary of the Treasury), or both, as the FDIC determines to be appropriate. 12 U.S.C. § 1823 (c)(4)(G)(ii).

[113] 12 U.S.C. § 1823(c)(4)(E)(i), as added by § 141(a)(i) of Pub. L. 102-242 (1991).

[114] 12 U.S.C. § 1823(c)(4)(E)(iii), as added by § 141(a)(i) of Pub. L. 102-242 (1991).

[115] *See* Receivership Rules, 58 Fed. Reg. 67,662, 67,663 (Dec. 22, 1993) (adopting § 360.1 of FDIC resolution rules relating to least-cost resolution).

41 to the FDIA, specifically addressing foreign deposits. Section 41(a) provides that the FDIC may not, directly or indirectly, make any payment or provide any assistance under the FDIA in connection with an insured depository institution that would have the direct or indirect effect of satisfying, in whole or in part, any claim that would constitute a foreign deposit.[116] Section 41(b), however, provides an exception to this prohibition if the Board of Directors of the FDIC determines that the action "is not inconsistent with any requirement of Section 13(c) [of the FDIA]."[117] Thus, it would appear that Section 41 too is simply subsumed within the scope of the least-cost requirement and systemic risk exception in Section 13(c)(4).

In non-systemic risk cases, the least-cost resolution requirement in Section 13(c)(4)(A) places some constraint on the FDIC's prior practice of providing protection to uninsured depositors. Prior to the FDICIA amendment to Section 13(c)(4), the FDIC was able to provide protection to uninsured depositors of a failed bank as long as the cost of the resolution was less than the cost of an "insured deposit payoff," i.e., a straight liquidation and payment to insured depositors only.[118] Prior to the FDICIA amendment, it was the general practice of the FDIC to transfer both insured and uninsured deposits to an acquirer in a purchase and assumption transaction because the cost of this approach was typically less than the cost of a straight liquidation and insured deposit payoff.[119] After the FDICIA amendment, the FDIC changed its approach to purchase and assumption transactions. The FDIC Resolutions Handbook describes the effect of the least-cost requirement on purchase and assumption bids as follows:

> If the bid includes assumption of all deposits, including uninsured

---

[116] 12 U.S.C. § 1831r(a).

[117] 12 U.S.C. § 1831r(b).

[118] *See* 58 Fed. Reg. at 67,663. *See also* FDIC, *Resolutions Handbook*, at 13.

[119] The cost advantage to the FDIC of resolving through a purchase and assumption agreement over an insured deposit payoff is a function of at least three factors. First, a bidder in a purchase and assumption transaction is expected to pay a premium for the franchise value of the deposits being assumed. This potential premium is lost if the FDIC chooses to use an insured deposit payoff. Second, a bidder may place a higher value on the assets transferred as part of a purchase and assumption transaction than what the FDIC could expect to receive in a piecemeal liquidation process of the assets. The FDIC refers to the loss in value for assets left for liquidation in the receivership as the "liquidation differential". FDIC, *Resolution Handbook*, at 21 n.8. Third, the FDIC incurs additional direct and indirect expenses when it handles the liquidation of assets itself, adding to the overall cost of the resolution. For an analysis of the effects of a resolution technique on the cost of resolution, see Rosalind L. Bennett & Haluk Unal, *The Effects of Resolution-Method Choice on Resolution Costs in Bank Failures* (July 2009), *available at* www.fdic.gov/bank/analytical/cfr/2009/july/CFR_2009_bennett.pdf.

> deposits, the premium paid must be at least as large as the losses that would have been incurred by customers with uninsured deposits in a payoff in order for the bid to be considered less costly than liquidation.[120]

The initial effect of the least-cost requirement was to make "whole bank" purchase and assumption bids less competitive than purchase and assumption bids covering only insured deposits.[121] As discussed below, the addition of the national depositor preference provision to the FDIA in 1993 has mitigated the effect of the least-cost requirement on the assumption of *domestic* uninsured deposits to the extent that the failed bank has significant general creditors (e.g., senior note holders) or foreign depositors (and relatively little secured debt). If there are sufficient general creditor claims and foreign depositor claims to cover the losses in a failed bank, the FDIC could conclude that the domestic uninsured depositors would suffer no loss (or a reduced loss) in a straight liquidation of the failed bank, thereby facilitating a purchase and assumption agreement covering both insured and domestic uninsured deposits.

The least-cost requirement has had an even more significant effect on the use of bridge banks. Prior to the FDICIA amendment, it was the practice of the FDIC to transfer both insured and uninsured deposits to a bridge bank.[122] After the FDICIA amendment, the FDIC has stated that it will not transfer uninsured deposits to a bridge bank if it projects that it is going to incur any loss in the bridge bank.[123] This is because the FDIC applies the least-cost test twice in cases in which it uses a bridge bank: first, before a failed bank goes into the bridge bank; and second, at the time of the final resolution of the bridge bank.[124] If the FDIC's initial cost analysis made when a failed bank is being placed into a bridge structure indicates that a loss is going to occur in the bridge bank, the FDIC has said that it will transfer only insured deposits to the bridge

---

[120] FDIC, *Resolutions Handbook*, at 14. *See* FDIC, *Managing the Crisis*, at 61. *See also* Christopher T. Curtis, *The Status of Foreign Deposits Under the Federal Depositor-Preference Law*, 21 U. Pa. J. Int'l Econ. L. 237, 240 n.16 (2000) ("The FDIC may cover uninsured deposits where they pay for themselves through a sufficiently increased premium paid by the failed bank's acquirer.").

[121] FDIC, *Managing the Crisis*, at 15–16.

[122] FDIC, *Managing the Crisis*, at 177.

[123] *Id*. at 177 ("Since FDICIA, the FDIC has passed only insured deposits to a bridge bank when there is an expected loss to the receivership; uninsured depositors share in any loss with the FDIC.").

[124] *Id*. at 182.

bank in compliance with the least-cost requirement.[125] The least-cost requirement can be waived only in a systemic risk case.[126]

The most recent examples of the use of a bridge bank by the FDIC confirm the effect that the least-cost requirement has had on the bridge bank mechanism. The bridge-bank-like mechanism used by the FDIC to resolve IndyMac Bank in 2008 involved the transfer of only insured deposits to the bridge bank.[127] Uninsured portions of deposits were left behind in the receivership and suffered losses.[128] In two subsequent uses of a bridge bank in 2009, the FDIC likewise transferred only insured deposits to the bridge bank.[129] In adopting its rule for resolution plans for large insured depository institutions in 2012, the FDIC also appeared to assume that a bridge bank would only assume insured deposits.[130] However, as discussed below, in guidance issued in December 2014, the FDIC appears to have opened the possibility of the use of a bridge bank to assume both insured and uninsured

---

[125] *Id*. In 1992 shortly after the enactment of the least-cost requirement, the FDIC encountered this constraint in its resolution of the 20 bank subsidiaries of First City Bancorporation of Texas. Each of the bank subsidiaries was passed to a separate bridge bank. In the four bridge banks for which the FDIC projected a loss, no uninsured deposits were passed to the bridge bank. In the other 16 banks, both insured and uninsured depositors were passed to the bridge banks. *Id*. at 180.

[126] *Id.* at 179 & n.7 ("[A]s a result [of the least-cost requirement], in all future bridge banks only insured deposits will be placed in the bridge bank, except in cases of systemic risk or cross guarantee in which there is no loss in the bank.").

[127] *See* Press Release, FDIC Establishes IndyMac Federal Bank, FSB as Successor to IndyMac Bank, F.S.B., Pasadena, California (July 11, 2008), *available at* https://www.fdic.gov/news/news/press/2008/ pr08056.html.

[128] *Id*. Because the Dodd-Frank Act retroactively increased insurance coverage from $100,000 to $250,000 for depositor claims in receiverships commenced between January 1, 2008 and October 3, 2008, the original projected losses for uninsured deposit amounts in IndyMac as of July 11, 2008 were subsequently reduced in amount. *See* Dodd-Frank Act, § 335, amending 12 U.S.C. § 1821(a)(1)(E).

[129] *See* Press Release, FDIC, FDIC Creates Bridge Bank to Take Over Operations of Independent Bankers' Bank, Springfield, Illinois (Dec. 19, 2009), *available at* http://www.fdic.gov/news/news/press/2009/pr09237.html; Press Release, FDIC, FDIC Creates Bridge Bank to Take Over Operations of Silverton Bank, National Association, Atlanta, Georgia (May 1, 2009), *available at* https://www.fdic.gov/news/news/press/2009/pr09061.html. It appears that in the case of each of these two small banks there were virtually no uninsured deposits. *Id*.

[130] FDIC, Resolution Plans Required for Insured Depository Institutions with $50 Billion or More in Total Assets, 77 Fed. Reg. 3075, 3081 (Jan. 23, 2012) (listing among the potential strategies for the payment of depositors a "transfer of insured deposits to a bridge institution chartered to assume such deposits, as an interim step prior to the purchase of the deposit franchise and assumption of such deposits by one or more insured depository institutions").

deposits.[131]

The least-cost resolution requirement in Section 13(c)(4)(A) creates a potential cost impediment for a bidder that wishes to assume the uninsured deposits, including foreign deposits, of a failed bank. The potential cost impediment under Section 13(c)(4)(A) for assuming foreign deposits was further heightened in 1993 when the depositor preference provision was added to the FDIA.[132] By subordinating foreign deposits to both domestic insured *and* domestic uninsured deposits, the cost to a bidder that wishes to assume foreign deposits has become even higher under the least-cost resolution test after the 1993 amendment. Because of the depositor preference provision, it will always cost a potential bidder more to assume a foreign deposit than a domestic uninsured deposit. The cost to a bidder will be a function of the overall loss ratio on the failed bank's assets and the ratio of domestic deposits (as priority claims) to foreign deposits (as non-priority claims). As the ratio of foreign deposits to domestic deposits increases, the cost to the bidder of assuming the foreign deposits will increase. Conversely, as the ratio of foreign deposits (and other general creditor claims) to domestic deposits increases, the cost to the bidder of assuming the domestic uninsured deposits will decrease.

The combination of the legislative changes made to the FDIA in 1991 and 1993 creates a significant (though not insurmountable) obstacle to the use of a purchase and assumption transaction to resolve a non-systemically important bank with foreign deposits. Because certain foreign deposits simply represent a money market funding mechanism, the willingness of a bidder to incur the additional costs of assuming such foreign deposits may be limited. A bidder may, however, be more willing to incur the additional costs for assuming foreign deposits held by depositors who are part of the core customer base of the failed bank (e.g., corporate customer deposits swept overnight into a Cayman Islands branch).

The impediment for a bidder wishing to bid for the foreign deposits of a failed bank will be a matter of cost. The impediment for the FDIC transferring foreign deposits to a bridge bank may be a matter of law. If the FDIC projects any loss in the bridge bank, it appears that it will not be able to transfer the foreign deposits to the bridge bank in the absence of a systemic risk determination. There will thus be a strong incentive for the U.S. authorities to invoke the systemic risk exception in the case of a failed bank with sizable

---

[131] *See* Press Release, FDIC, FDIC Issues Guidance for the Resolution Plans of Large Banks (Dec. 17, 2014), *available at* https://www.fdic.gov/news/news/press/2014/pr14109.html.

[132] 12 U.S.C. § 1821(d)(11)(A), as added by Pub. L. No. 103-66, § 3001(a) (1993).

foreign deposits to preserve the option for the use of a bridge bank if an immediate purchase and assumption transaction covering the foreign deposits cannot be arranged.[133] The demonstration effect of a failure to provide adequate treatment for foreign deposits even in the case of a single failed bank could have systemic consequences for the larger U.S. banking system.

Experience with the Systemic Risk Exception

Although enacted in 1991, the systemic risk exception in Section 13(c)(4)(G) was only used by the FDIC for the first time during the 2008 financial crisis. The first use of the systemic risk exception came in an open bank transaction announced in September 2008 under which Citicorp proposed to acquire Wachovia Bank, N.A. ("Wachovia Bank"), which was facing imminent failure.[134] In analyzing the least-cost requirement for a resolution of Wachovia Bank, the Treasury, the Federal Reserve Board and the FDIC concluded that a least-cost resolution would impose large losses on the senior debt holders and foreign depositors of Wachovia Bank.[135] Wachovia Bank held approximately $53 billion in foreign deposits. The U.S. authorities were concerned that imposing large losses on the general creditors and foreign depositors of Wachovia Bank could intensify liquidity pressures on other U.S. banks that were vulnerable at that time to a loss of confidence by their own creditors and foreign depositors. This was one of the factors cited by the U.S. authorities in invoking the systemic risk exception.[136] The Citigroup acquisition of Wachovia

---

[133] The research staff of the FDIC has previously identified the consequences of the national depositor preference provision for foreign deposits. *See* James A. Marino & Rosalind L. Bennett, *The Consequences of National Depositor Preference*, 12 FDIC Banking Review No. 2, 19 (1999). The research staff speculated that one consequence of the depositor preference provision would be a greater probability of a systemic risk determination being made in the case of a bank with sizable foreign deposits. *Id*. at 37. They noted that without a systemic risk determination, the foreign deposits would come behind domestic U.S. deposits and that because of that prospect, the foreign authorities would have a strong incentive to ring-fence the foreign branches of the U.S. bank. *Id*. at 36–37. They thus anticipated the issues that have recently been raised by the FSA and the Bank of England.

[134] *See* Government Accountability Office, *Federal Deposit Insurance Act, Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision*, GAO-10-100 12 (April 2010) [hereinafter *GAO Report*].

[135] *See id*. at 13–14. *See also* Minutes of the Meeting of the Board of Directors of the Federal Deposit Insurance Corporation by Conference Call, Sept. 29, 2008, *available at* http://fcic.law.stanford.edu/documents/view/506; Memorandum to the FDIC Board of Directors from James R. Wigand and Herbert J. Held, Sept. 29, 2008, *available at* http://fcic.law.stanford.edu/documents/view/140.

[136] The FDIC staff's preliminary estimate was that the Citigroup-Wachovia transaction would produce no loss to the deposit insurance fund because Citigroup proposed to absorb the

Bank ultimately was not consummated because Wells Fargo agreed to acquire Wachovia Bank on an unassisted basis.

By chance (or rather more accurately, by predestination) the U.S. authorities were required to address the systemic risk exception again in another transaction involving Citigroup. In November 2008, the Treasury, the Federal Reserve Board and the FDIC announced an agreement to provide open bank assistance to Citigroup itself.[137] Part of the assistance consisted of a loss-sharing arrangement with the FDIC under the FDIA and with the Treasury under the TARP legislation. The FDIC assistance was provided pursuant to the systemic risk exception in the FDIA.[138] The U.S. authorities determined that resolving Citigroup's insured bank subsidiaries under the least-cost requirement would impose significant losses on the creditors and uninsured depositors of these subsidiaries, threatening to further undermine confidence in the U.S. banking system.[139] Citigroup had a large international operation with more than $500 billion in foreign deposits. The U.S. authorities were concerned that imposing losses on these foreign depositors could intensify global liquidity pressures and increase funding problems for other U.S. banking institutions with significant amounts of foreign deposits.[140] This was an important factor in a mix of factors that supported the determination that the systemic risk exception should be invoked in the Citigroup case.

Thus, at the time of the financial crisis, the U.S. authorities specifically cited the presence and size of the foreign deposit base as an important consideration in invoking the systemic risk exception to authorize open bank assistance to two systemically important banking institutions. As noted above, an amendment made to the FDIA by the Dodd-Frank Act has now eliminated the possibility of open bank assistance. Extraordinary assistance under the FDIA, however, can still be given under the systemic risk exception, but only after the failing

first $42 billion in losses in the transaction. The FDIC was nonetheless required to make a systemic risk determination in order to provide open bank assistance under Section 11(a)(4)(C) of the FDIA. The FDIC staff also concluded that in the event of its failure, Wachovia Bank had sufficient uninsured obligations such as foreign deposits and senior and subordinated debt to absorb the expected losses and to protect its insured deposits without requiring assistance from the deposit insurance fund. *See GAO Report* at 13 n.12.

[137] *See* Joint Statement by Treasury, Federal Reserve, and the FDIC on Citigroup (Nov. 23, 2008), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20081123a.htm.

[138] *See* Minutes of the Meeting of the Board of Directors of the Federal Deposit Insurance Corporation by Conference Call, Nov. 23, 2008, *available at* http://fcic.law.stanford.edu/documents/view/1023 [hereinafter Minutes for Citicorp Assistance].

[139] *See GAO Report* at 24–26.

[140] *See id.* at 25. *See also* Minutes for Citicorp Assistance.

institution is put into a receivership proceeding.[141] The systemic risk exception to the least-cost requirement would permit the FDIC to provide protection to foreign depositors in such a receivership resolution. This provides substantially greater flexibility for the treatment of foreign depositors in the case of a systemic bank than in the case of a non-systemic bank.

United Commercial Bank—A Recent Example

Notwithstanding the additional cost that must be borne by a bidder for the foreign deposits of a failed bank, there is one recent example confirming that in appropriate circumstances a bidder may be prepared to pay that additional cost. This example involved United Commercial Bank ("UCB"), an $11 billion bank headquartered in San Francisco, which failed in November 2009.[142] It operated a branch in Hong Kong and a subsidiary bank in Shanghai, China.[143] The FDIC resolved UCB using a purchase and assumption transaction with East West Bank, another California-based bank, as acquirer. East West Bank assumed all the deposits (other than certain brokered deposits) of UCB, including the deposits in UCB's Hong Kong branch. The deposits in the Hong Kong branch were insured by the Hong Kong Deposit Insurance Scheme. East West Bank also acquired the Shanghai bank subsidiary of UCB. East West Bank paid the FDIC a premium equal to 1.1 percent of all the deposits of UCB.[144] The FDIC provided East West Bank protection on $7.7 billion of UCB's assets that it was acquiring through a loss-sharing provision in the purchase and assumption agreement.

The FDIC determined that East West Bank's acquisition of all of UCB's deposits met the least-cost resolution requirement.[145] The FDIC indicated that the deposit insurance fund did not incur any loss by including the foreign deposits in the transaction. In fact, the FDIC indicated that by including the foreign deposits in the transaction, it reduced the exposure of the deposit insurance fund by avoiding ring-fencing by foreign authorities.[146] The premium paid by East West Bank presumably included an amount equal to the

---

[141] 12 U.S.C. § 1823(c)(4)(G)(i), as amended by Pub. L. 111-203, § 1106(b)(1)(B)(2010).

[142] Press Release, FDIC, East West Bank, Pasadena, California Assumes All the Deposits of United Commercial Bank, San Francisco, California (Nov. 6, 2009), *available at* https://www.fdic.gov/news/news/press/2009/pr09201.html.

[143] *Id.*

[144] *Id.*

[145] *Id.*

[146] Press Release, FDIC, United Commercial Bank Fact Sheet: Discussion of Additional Issues, *available at* http://www.fdic.gov/news/news/press/2009/pr09201c.html.

projected loss that the Hong Kong depositors would have suffered in a straight liquidation. The remainder of the premium paid by East West Bank presumably represented the franchise value that East West Bank attributed to the acquisition of the domestic deposit base of UCB.

It appears that the relatively small size of the Hong Kong deposit base compared to the domestic deposit base allowed East West Bank to cover the additional cost of including the foreign deposits in the purchase and assumption transaction. The FDIC's statement to the effect that the inclusion of the Hong Kong deposits reduced the exposure of the deposit insurance fund by avoiding ring-fencing also suggests that the quality or quantity of the assets booked at the Hong Kong branch (and potentially subject to any ring-fencing action by the Hong Kong authorities) may have been higher or greater than that of the average assets booked in the U.S. operations of UCB.[147] Structuring a resolution that covered all the foreign deposits of UCB is emblematic of the commitment that the FDIC has shown to facilitating a coordinated approach to cross-border resolution. It was especially important in this case because the deposits in the Hong Kong branch were insured by the Hong Kong Deposit Protection Scheme. Any subrogated claim by the Hong Kong Deposit Protection Scheme resulting from an insurance payment to the depositors of the Hong Kong branch would have faced the prospect of subordination under the FDIA. Such an outcome would have been a matter of deep concern to all foreign deposit insurance administrators. Finally, as the FDIC acknowledged, coordination with the Hong Kong Monetary Authority and the China Bank Regulatory Commission was an important factor in achieving a resolution that allowed the smooth transfer of the Hong Kong branch and the Chinese bank subsidiary to East West Bank. Waivers of, or expedited treatment for, regulatory approvals by a host authority will almost invariably be required in any cross-border transaction (including a bridge bank transaction) to be consummated over a resolution weekend.

Foreign Branches—Future Prospects

The FDIA provides a range of authority to the FDIC to facilitate the resolution of a failing banking institution. The systemic risk exception in the FDIA is particularly important in a cross-border situation because it will allow the FDIC to include foreign deposits in a bridge bank transaction or a purchase and assumption transaction despite the increased cost to the deposit insurance fund resulting from the inclusion of foreign deposits in the transaction.

In the case of a failure of a non-systemically important bank, the inclusion

---

[147] *Id.*

of the foreign deposits in the resolution mechanism will prove more challenging. In a purchase and assumption transaction, a bidder wishing to assume the foreign deposits will have to pay a premium to the FDIC at least equal to the loss the foreign deposits would have suffered in a straight liquidation of the failed bank. Moreover, the FDIC may not have the ability to transfer the foreign deposits of a non-systemically important failed bank to a bridge bank.

In the case of a failure of a systemically important bank, the FDIC would have the legal authority to transfer foreign deposits to a bridge bank without regard to the least-cost requirement. However, for the reasons discussed above, it may not always be practicable for the FDIC to implement a bridge bank mechanism for a large complex banking institution. As suggested above, the answer to the practical difficulty of implementing a bridge bank strategy for a large complex banking institution may lie in the use of a bridge financial company mechanism under Title II of the Dodd-Frank Act.

There will also be other constraints on the options for resolving even a systemically important bank under the FDIA. Some observers believe that the FDIC would not have the capacity to resolve a large complex bank using either a bridge bank or a purchase and assumption technique. These observers point out that while the FDIC has used these techniques successfully in the past, it has generally been for banks that are much smaller in size and simpler in structure than the banks that the FDIC might confront in a future resolution process.[148] Ironically, the resolution of Washington Mutual Bank, the largest bank ever to have been resolved by the FDIC, through a purchase and assumption agreement with JPMorgan Chase in September 2008, may signal rising constraints on the use of a purchase and assumption transaction in a future resolution of a large complex bank.[149] Washington Mutual Bank, while

---

[148] *See, e.g.*, David Skeel, THE NEW FINANCIAL DEAL, UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 125 (2011) (noting that the FDIC has "struggled mightily in all of its larger cases"); Jeffrey V. Gordon & Wolf-Georg Ringe, *Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take* 11–12 (Aug. 2014), http://ssrn.com/abstract=2361347 (noting that the FDIC had no experience between 1991 and 2007 in dealing with large bank failures and hence little experience in addressing purchase and assumption agreements that transferred uninsured as well as insured deposits); Robert DeYoung & Jack Reidkill, *A Theory of Bank Resolution: Political Economics and Technological Change 12–13* (Jan. 31, 2008), https://www.fdic.gov/bank/analytical/cfr/2008/apr/CFR_SS_2008_DeYoung_Reidhill.doc (noting that completing a determination as to insured and uninsured accounts in a large bank over a resolution weekend would be operationally difficult). For an FDIC response to criticism of its potential ability to resolve a large institution, *see* FDIC Rebuts Inaccurate Op-ed, https://www.fdic.gov/news/letters/rebuttal_04072010.html.

[149] *See* Press Release, FDIC, JPMorgan Chase Acquires Banking Operations of Washington Mutual-FDIC Facilities Transaction that Protects All Depositors and Comes at No Cost to the

large, was relatively simple in its structure and operations. This facilitated the use by the FDIC of a "whole bank" purchase and assumption transaction transferring substantially all the assets and all the liabilities (other than senior and subordinated debt claims) to JPMorgan Chase. The transaction was also facilitated by the fact that JPMorgan Chase had the opportunity to conduct substantial due diligence as part of a private bidding process that preceded the FDIC resolution bidding process.

Washington Mutual Bank had a relatively large amount of senior and subordinated debt outstanding. This senior and subordinated debt was sufficient in amount to absorb losses under the depositor preference provision in the FDIA and allowed the FDIC as receiver to transfer virtually all the assets of Washington Mutual Bank to JPMorgan Chase to offset the amount of the insured and uninsured deposits that JPMorgan Chase was assuming (less a $1.9 billion premium paid by JPMorgan Chase).[150] In its press release announcing the transaction, the FDIC stated that there would be no cost to the deposit insurance fund from the transaction.[151] This is a powerful example of the effect of the depositor preference provision on the cost of resolution of a large bank. Large banks like Washington Mutual Bank rely to a greater extent than small banks on non-deposit funding, such as senior debt. Because senior debt (and subordinated debt) bear losses ahead of deposit liabilities under the liquidation priority in the FDIA, it may be feasible for the FDIC under the least-cost test to arrange a transaction covering both insured and uninsured (domestic) deposits for a bank with a significant amount of senior and subordinated debt. In the Washington Mutual Bank case the depositor preference provision allowed the FDIC to fashion a resolution for Washington Mutual Bank in which both insured and uninsured depositors were protected.

The most prominent outcome of the Washington Mutual Bank resolution could, however, potentially be a negative one. JPMorgan Chase has faced very substantial costs from contingent liabilities relating to the prior mortgage origination and securitization activities of Washington Mutual Bank.[152] Many

---

Deposit Insurance Fund (Sept. 25, 2008), *available at* https://www.fdic.gov/news/news/press/2008/pr08085.html.

150 *Id.*

151 *Id.*

152 *See, e.g.* Tom Schoenberg, *JP Morgan Reaches Record $13 Billion Mortgage Settlement*, Bloomberg (Nov. 19, 2013), *available at* http://www.bloomberg.com/news/2013-11-19/jpmoregan-settlement-announced-by-u-s-justice-department1-.html. JPMorgan estimated that more than 80 percent of its reserves for mortgage-backed securities litigation related to activities of Bear Stearns and Washington Mutual Bank. *See* JPMorgan Chase & Co., Form 8-K Current Report (Oct. 11, 2013), Exhibit No. 99.1, Earnings Presentation Slides at 2 n.3.

of these claims have been made by the U.S. government itself. The U.S. government has been particularly aggressive in bringing legal actions against JPMorgan Chase and Bank of America for the prior activities of failing institutions that they acquired with the encouragement of the U.S. government during the financial crisis.[153] Future bidders for the operations of a large failed bank will be very reluctant to take on the risk of contingent liabilities, including pending litigation or other inchoate claims involving public or private claimants. This unforeseen consequence of the Washington Mutual Bank transaction may prove one of the largest obstacles to the future use of a purchase and assumption technique for a large bank. Here too the depositor preference provision in the FDIA may offer at least a partial solution to the problem. Contingent liabilities, like other general creditor claims, are statutorily subordinated to deposit liabilities and so can be left behind in the receivership while deposit liabilities with offsetting assets can be transferred to a bridge bank or a third-party acquirer. But the FDIC in its corporate capacity would of course still have to agree to indemnify the bridge bank or other acquirer against the risk of such contingent liabilities even when they are left behind in the receivership.[154] Any ambiguity on this point of indemnification from the FDIC will undercut the advantage that the depositor preference provision provides for handling the problem of contingent liabilities.

Other regulatory considerations also make it unlikely that a large U.S. banking institution could play a leading role in acquiring the business of another large or even medium-sized failing banking institution. The Dodd-Frank Act has added new limits on, and new regulatory considerations to the approval process for, acquisitions by large banking institutions.[155] In addition,

---

[153] *See, e.g.*, Christoper M. Matthews, *Federal Prosecutors Emerge From Mortgage-Fraud Trial With New Weapon, Influential Judges Have Signed Off on Novel Interpretation of Obscure Law*, WALL ST. J. (Oct. 23, 2013), *available at* http://online.wsj.com/news/articles/SB10001424052702304069604579154033805282804.

[154] The standard FDIC purchase and assumption agreement includes a provision for an indemnity by the FDIC to the acquirer for any liabilities that are not expressly assumed by the acquirer under the terms of the purchase and assumption agreement. As part of its $13 billion mortgage settlement with JPMorgan Chase, the Justice Department required JPMorgan Chase to waive certain claims of indemnification against the FDIC under the purchase and assumption agreement for Washington Mutual Bank. *See* Press Release, Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), *available at* http://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement.

[155] *See, e.g.*, 12 U.S.C. § 1842(c)(7)(requiring the Federal Reserve Board to take into account the extent to which a proposed acquisition, merger or consolidation would result in greater or

various prudential considerations, such as increased capital requirements for large banking institutions, create further disincentives for these institutions to grow in size.[156] Virtually all the current prudential and legal considerations militate against a large U.S. banking institution acquiring a failed bank other than one of relatively inconsequential size. These considerations suggest that the bidding process for a large failed bank or parts of a large failed bank will be significantly less robust than the historical FDIC experience with bidding processes. The answer as to how a large complex bank would be resolved in the future may depend less on the traditional methodologies used under the FDIA and more on the new methodologies being developed by the FDIC under Title II of the Dodd-Frank Act.

Recent FDIC Guidance

The several theses propounded in this article may shortly be put to the test. In December 2014, the FDIC issued additional guidance (the "Guidance") relating to the resolution plans required for large banks under a final rule that the FDIC adopted in January 2012.[157] The FDIC resolution plan requirement for large banks is intended to complement the resolution plan requirements applicable to large bank holding companies and designated non-bank financial companies under Section 165(d) of the Dodd-Frank Act.[158] The Guidance is

more concentrated risks to the stability of the U.S. banking or financial system).

[156] For the most recent manifestation of heightened capital requirements for large banks, see Risk-Based Capital Guidelines, Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies, 79 Fed. Reg. 75473, 75475 (Dec. 18, 2014) (applying a risk-based capital surcharge to U.S. bank holding companies identified as global systemically important banking organizations to "induce [a covered bank holding company] to reduce its risk of failure, internalize the negative externalities it poses, and correct for competitive distortions created by the perception that it may be too big to fail"). *See also* Opening Statement by Janet L. Yellen, Chair, Federal Reserve Board (Dec. 18, 2014), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/yellen-statement-20141209.htm (stating that the proposed risk-based capital surcharge "would encourage [covered bank holding companies] to reduce their systemic footprint and lessen the threat that their failure could pose to overall financial stability").

[157] FDIC, Press Release, FDIC Issues Guidance for the Resolution Plans of Large Banks (Dec. 17, 2014), *available at* https://www.fdic.gov/news/news/press/2014/pr14109.html. *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 77 Fed. Reg. 3,075 (Jan. 23, 2012) (adopting the resolution plan requirement codified at 12 C.F.R. § 360.10). The resolution plan rule for large banks requires that the resolution plan provide depositors with access to their insured deposits within one business day of the institution's failure (or two business days if the failure occurs on a day other than Friday), maximize the net present value from the sale or disposition of the assets, and minimize the amount of any loss to be realized by the institution's creditors. 12 C.F.R. § 360.10(a).

[158] *See* 77 Fed. Reg. at 3,076.

significantly more detailed than the guidance that was provided in the Federal Register when the resolution plan rule was adopted.[159] The Guidance deals specifically with various of the issues discussed in this article.

The Guidance begins with a broad statement of the resolution strategies that should be included in a resolution plan. The Guidance indicates that a resolution plan should include one strategy that involves the liquidation of the bank, including a payout of insured deposits.[160] Although a payout of insured deposits at a large bank is the most undesirable strategy as a practical matter, a liquidation analysis must be prepared to provide the basis for a least-cost comparison with other resolution strategies, such as a bridge bank or a purchase and assumption transaction or transactions. The Guidance further indicates that a resolution plan should also include one strategy that involves the separation and sale of the bank's deposit franchise, core business lines and other major assets to multiple acquirers (a "Multiple Acquirer Strategy").[161] The Multiple Acquirer Strategy may be based on a combination of a purchase and assumption transaction, an initial public offering ("IPO"), and a liquidation.[162] As the FDIC expressly recognizes in the Guidance, the complexity of a Multiple Acquirer Strategy will likely require the use of one or more bridge banks as an interim step in structuring a Multiple Acquirer Strategy.[163]

The Guidance is more detailed in discussing certain elements of a strategy. For example, the Guidance specifically states that the resolution plan should describe whether any strategy involving a purchase and assumption of deposit liabilities includes an "All Deposit" transaction or an "Insured Deposit Only" transaction.[164] The Guidance further states that a resolution plan proposing a bridge bank strategy should justify "why it may be least costly to transfer all deposits, including uninsured deposits, to a bridge bank rather than using a strategy in which uninsured depositors are exposed to losses."[165] This statement suggests that the FDIC may be reconsidering its previous position that only insured deposits would be transferred to a bridge bank when any loss to the FDIC would result from the operation of the bridge bank. This would

---

[159] FDIC, *Guidance for Covered Insured Depository Institution Resolution Plan Submissions* (Dec. 17, 2014), *available at* https://www.fdic.gov/news/news/press/2014/pr14109a.pdf.

[160] *Id.* at 4.

[161] *Id.*

[162] *Id.*

[163] *Id.* at 4–5.

[164] *Id.* at 6.

[165] *Id.* at 5.

constitute a significant advance over previous FDIC indications. The Guidance is specific in discussing the need for the bank to demonstrate in its resolution plan how such an approach (i.e., transferring uninsured as well as insured deposits) is least costly to the deposit insurance fund.[166] As suggested above, if there are sufficient general creditor claims (including foreign depositor claims) to absorb the losses in a failed bank, it may be possible to demonstrate that such an approach would be least costly. However, also as suggested above, the protection of the uninsured domestic deposit claims in this scenario would come at the price of imposing significant losses on the foreign depositors as well as other general creditors.

The Guidance specifies certain points that should be covered in the least-cost analysis contained in a resolution plan, such as the premium expected from the sale of the deposit franchise after a bridge bank has been established versus the expected premium for the deposit franchise in an immediate sale and the estimated marginal cost of operating the bridge bank for the estimated period of time that it is expected to be in operation.[167] This statement in the Guidance likewise suggests a broader approach to the calculation of the least-cost requirement for a bridge bank than prior statements of the FDIC on the topic.[168] The least-cost analysis for a bridge bank structure is affected by the fact that no premium for a deposit franchise is paid by the bridge bank at the time of the initial transfer of assets and liabilities to it from the receivership. The statement in the Guidance suggests that the FDIC might be prepared to take into account the projected premium for the deposit franchise that might be paid on the subsequent sale of the bridge bank to an acquirer or acquirers or the enhanced value derived from a subsequent IPO of the bridge bank. This approach would facilitate the use of a bridge bank.

The Guidance does not expressly address foreign deposit claims. Likewise, it does not expressly address the systemic risk exception. The discussion of the need for demonstrating a least-cost strategy may be read implicitly to exclude any reliance on a systemic risk exception. For purposes of a resolution plan, the possibility of transferring foreign deposits to a bidder (without the intermediary use of a bridge bank) will thus depend upon the overall premium that the bidder would be prepared to pay, which must be equal at least to the amount of the losses that the foreign deposits would suffer in a straight liquidation. It

---

[166] *Id.* at 7–8.

[167] *Id.* at 7.

[168] *See, e.g.*, FDIC, *Managing the Crisis*, at 182 ("The FDIC compares the estimated cost of a bridge and its subsequent resolution to the estimated cost of the two alternatives: an immediate sale without the bridge structure or a payoff of deposits.").

is not clear whether, in calculating the losses that the foreign deposits would suffer in liquidation, a bank in its resolution plan may take into account the possible ring-fencing of the assets in the foreign branches by host authorities. Such ring-fencing might reduce the level of loss that the foreign depositors would incur in a straight liquidation under the FDIA provisions and so reduce the amount that a bidder would need to pay as a premium with respect to the foreign deposits under the FDIC's interpretation of the least-cost requirement. The ring-fencing calculation will depend in part on whether a particular foreign branch is principally a lending office (and local asset generator) or principally a funding office (with a large "due from" its head office). It will also depend on the level of host jurisdiction requirements for asset maintenance at the branch. For purposes of a resolution plan, the possibility of transferring foreign deposits to a bridge bank will also depend upon whether the FDIC is prepared to take into account the projected premium for the deposit franchise that might be paid on the subsequent sale of the bridge bank or the enhanced value from a subsequent IPO of the bridge bank. Even in the case of the idiosyncratic failure of a large bank, the process of projecting asset losses and possible premium to be paid on domestic uninsured deposits and foreign deposits will be complex and highly sensitive to the assumptions used. It is not clear how an institution preparing a resolution plan will be able to develop and support its projections. It is also not clear how the FDIC would validate such projections. The traditional methodologies used by the FDIC in the past (in connection with much smaller institutions) may not be as readily adaptable to a large bank resolution.[169] The next iteration of resolution plans from the large banks will provide an opportunity for the FDIC to consider and perhaps clarify its position on these issues.

CONCLUSION

This article has focused on the treatment of foreign deposits in a bank resolution because it is a critical issue in its own right. It is also symptomatic of many of the broader issues underlying cross-border resolution. The depositor preference provision in the FDIA as construed by the FDIC creates a significant problem for the cross-border resolution of a U.S. bank. The prospect of the subordination of foreign deposit claims in an FDIA receivership is regarded as

---

[169] As noted in note 29 *supra*, bidders in recent years have shown a strong preference for bidding on an "all deposit" basis rather than just on an "insured deposit" basis. This preference is reflected in a higher premium to be paid on an "all deposit" bid than on an "insured deposit" bid or in many cases the submission of only an "all deposit" bid. For the reasons discussed in that article, it is not unlikely that the same calculus would apply to a bid covering foreign deposits in addition to domestic uninsured deposits.

inequitable and politically unacceptable by host authorities and gives those authorities little choice but to threaten (and perhaps implement) ring-fencing if the depositors of the foreign branch are not otherwise to be protected. Ring-fencing is a powerful instinct on its own and might occur even in the absence of a legal regime like the depositor preference provision in the FDIA. In the face of a legal regime mandating subordination of foreign deposits, the host authorities have a complete justification for a ring-fencing response. The resulting ring-fencing would destroy elements of value that might otherwise be preserved in a more coordinated cross-border approach to resolution and will contribute to internecine warfare among resolution authorities.

The FDIC has suggested that the problem for foreign depositors under the depositor preference provision can be solved by the individual action of U.S. banks in making their foreign deposits dually payable at an office in the United States and at the foreign branch. Whatever the solution, the actualization of the subordination provision in the FDIA must be avoided. The actualization of the subordination provision in the event of a failure of even a single U.S. bank will have systemic consequences for the rest of the U.S. banking system. Other U.S. banks will not be able (or allowed by host authorities) to continue to operate through foreign branches in the aftermath of such an event. In the face of these consequences, the U.S. authorities will be compelled to invoke the systemic risk exception in the FDIA to allow the foreign deposits to be transferred to a bridge bank or to an acquiring bank, with support as needed from the deposit insurance fund. At a more elevated level, the risk of an actualization of the subordination provision in the FDIA for foreign depositors and other general creditors (as well as other vexing problems) may be avoided if a single-point-of-entry strategy can be implemented for the holding company of the U.S. bank under Title II. The new methodologies for resolution available under Title II of the Dodd-Frank Act, including the single-point-of-entry strategy, are the subject of Part V of this article.