BNY MELLON Northern Trust STATE STREET.

April 22, 2013

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429
Attention: Comments/Legal ESS
**RIN 3064-AE00**
Attention: Robert E. Feldman, Executive Secretary

Re: Deposit Insurance Regulations; Definition of Insured Deposit

Ladies and Gentlemen:

The Bank of New York Mellon Corporation, Northern Trust Corporation, and State Street Corporation (collectively, the "**Custody Banks**") are pleased to have the opportunity to provide comments with respect to the Notice of Proposed Rulemaking (the "**Proposal**" or the "**Proposed Rule**")[1] issued by the Federal Deposit Insurance Corporation (the "**FDIC**") concerning the definition of "insured deposit" in the FDIC's deposit insurance regulations and clarify the treatment of dually payable deposits.[2] Given the prevalence of foreign and non-dollar denominated deposits held by the Custody Banks, we have a significant interest in how depositor preference policy determinations are made by the FDIC and other global regulators.

The Proposed Rule is – as the accompanying official FDIC release notes – a response to the Consultation Paper (the "**Consultation Paper**") released by the Financial Services Authority (the "**FSA**") concerning the treatment of U.K. customers placing deposits with U.K. branches of U.S. bank holding companies ("**BHCs**").[3] While we do not oppose the Proposal, we do believe it is too modest and there is more the FDIC could do to holistically remediate the serious cross-border coordination issues raised by the FSA's Consultation Paper.

The Custody Banks appreciate the FDIC's concerns with extending the protection of the deposit insurance fund (the "**DIF**") to foreign depositors and agree that the issue of depositor preference raised by the FSA can, and should, be resolved without expanding

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1 78 Fed. Reg. 11,604 (February 19, 2013).

2 For the purposes of this commentary, "dually payable deposits" are those originating and payable outside the United States, but also potentially payable in the United States.

3 The FSA published the original Consultation Paper on September 11, 2012. Subsequently, the FSA's prudential authority was transferred to the new Prudential Regulatory Authority ("**PRA**") within the Bank of England. Because the PRA has not issued any pronouncements updating the Consultation Paper, this commentary refers to the FSA, not the PRA.

the scope of U.S. depositor insurance coverage. The approach we describe below achieves this result.

The Proposed Rule, if adopted to address deposit insurance, but not depositor preference, would present U.S. BHCs with U.K. operations with limited options to meet FSA expectations. As a practical matter, we would need to avail ourselves of two options, we could (1) unilaterally make U.K. deposit agreements dually payable by allowing them to be presented at a U.S. office of our companies; or (2) "subsidiarize" our U.K. branch operations (that is, convert our branches to subsidiaries). The Custody Banks believe a third policy option is far preferable to dual payability and subsidiarization and would comprehensively address the issues at the core of the FSA's concerns. The FDIC should determine administratively or by rule that the term "deposit liability" in Section 11(d)(11)[4] of the Federal Deposit Insurance Act (the "**FDIA**") includes deposits held at the foreign branches of U.S. banking organizations.[5]

Such an approach by the FDIC would finally resolve claims' priority issues that originate from the U.S. domestic depositor preference scheme.[6] We believe this policy is consistent with other FDIC policy objectives and will lead to more harmonious resolution of cross-border firms, should such a process be necessary. Importantly, it would also avoid the potential significant operational and policy concerns raised by a dual payability regime. This commentary is divided into two parts. Part I explains the statutory interpretation of the FDIA that the Custody Banks believe is more holistic and viable than the Proposal's limited approach. Part II addresses our concerns with dual payability.

## Part I: The FDIC should formally interpret the definition of "deposit liability" in Section 11(d)(11) of the FDIA as including foreign branch deposits. Doing so would address flaws with the U.S. depositor preference framework and facilitate cross-border resolutions.

The Custody Banks believe that the release of the Consultation Paper highlights the need for the FDIC to address the cross-border resolution policy implications of its current position that foreign branch deposits are subordinate to domestic deposits (*i.e.*, making them *pari passu* with general creditor claims). The financial crisis of 2007-2009 demonstrated that global banking regulators charged with administering bank resolution and deposit protection schemes must be able to operate on a coordinated basis across geographies.

Erecting and maintaining barriers to treating all depositors of a U.S. BHC the same will inherently obstruct the very cross-border cooperation efforts now at the forefront of the FDIC's reform agenda. The Consultation Paper recognizes this, noting that treating host-country deposits less favorably will make regulatory coordination more challenging.

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[4] 12 U.S.C. § 1821(d)(11).

[5] Section 11(d)(11) of the FDIA elucidates the depositor preference scheme to be followed in the resolution of a U.S. depository institution and gives priority to "deposit liabilities over the claims of general unsecured creditors.

[6] The current U.S. depositor preference scheme developed due to Congressional budget scoring practices and was, in no way, related to a Congressional desire to treat depositors differently based upon the location of their deposit account.

The Financial Stability Board (the "**FSB**") has also recognized the need for eliminating the subordination of foreign depositors and set forth the G-20's expectations on the development of cross-border resolution reform measures. In its *Key Attributes of Effective Resolution Regimes for Financial Institutions*, the FSB states, "[n]ational laws and regulations should not discriminate against creditors on the basis of their nationality, the location of their claim or the jurisdiction where it is payable."[7] We consider a potential FDIC re-interpretation of the definition of "deposit liability" in Section 11(d)(11) of the FDIA to be the most pragmatic policy step towards remediating problems caused by the current U.S. depositor preference regime and avoiding the many operational and legal issues that may arise if U.S. BHCs are left with no alternative to making deposits dually payable.

The best way to ensure U.K. customers are not subordinated to U.S. depositors in a resolution is for the FDIC to determine that foreign depositors, writ large, are not subordinated under U.S. law. Doing so would be sound public policy. It would address the prioritization scheme of the United States' domestic depositor preference statute without affecting the definition of "deposit" in 12 U.S.C. § 1813(*l*). That is, it would create parity for foreign depositors in the context of a large BHC resolution without compelling the FDIC to extend DIF protections to such deposits.

The FDIA permits the FDIC to adopt an interpretation of the term "deposit liability" in Section 11(d)(11) that includes foreign branch deposits.[8] The term "deposit liability" as used in the FDIA does not have any geographic qualification, and therefore provides the FDIC with scope to interpret the term in a manner that will best suit the FDIC's resolution responsibilities and will be consistent with global regulatory principles. Likewise, in the FDIA the terms "deposit liability" and "deposit" should not be read as synonymous. "Deposit liability," "deposit liabilities," and the more general "liability" are used throughout the FDIA. Those terms are not used in any U.S.-specific connotations and are not geographically-limited. On the other hand, the term "deposit" in Section 3(*l*) makes clear that foreign deposits payable *solely* outside the United States are not deposits under the FDIA.[9] It would be odd for the FDIC to now insist that "deposit liability" *cannot* include foreign deposits.

This practicality of construing foreign deposits as "deposit liabilities" makes even more sense when one considers basic FDIC operations, such as reporting. The Custody Banks (and all FDIC-regulated firms) file Call Reports that ask for foreign deposits to be reported as "deposit liabilities." In fact, the general instructions for Schedule RC-E to the Call Report refer to both domestic deposits and foreign branch deposits as "deposit liabilities."

We acknowledge that this additional step to clarify that "deposit liability" includes all deposits of the bank globally will require the FDIC to reconsider an earlier 1994 Advisory Opinion and may require further rulemaking.[10] Despite these facts, we strongly

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7 Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions", Key Attribute 7.4 (Oct. 2011).

8 "Deposit liability" is not defined in the FDIA or in any applicable FDIC regulations.

9 12 U.S.C. § 1813(*l*)(5)(A)(i)-(ii); *See also*, 12 C.F.R. § 330.3 (FDIC regulations implementing Section 3(*l*) of the FDIA).

10 FDIC Advisory Opinion, *"Deposit Liability" for Purposes of National Depositor Preference Includes Only Deposits Payable in U.S.*, FDIC 94-1 (February 28, 1994).

believe that a fundamental rethinking of the 1994 Advisory Opinion will be advantageous to the FDIC in connection with its resolution responsibilities, easy to administer operationally, bring the United States into compliance with pronounced G-20 and FSB resolution principles, avoid operational and legal difficulties for U.S. firms, and is consistent with current law.

## Part II: Dual Payability is an imperfect solution.

The confluence of the Consultation Paper and the Proposed Rule presents all U.S. BHCs with U.K. branches with two options: subsidiarize or make deposits dually payable. As a practical matter, most firms will only have one option. The significant structural and balance sheet management obstacles associated with subsidiarizing U.K. operations, or ring-fencing a stock of assets within the United Kingdom, will likely compel firms to make U.K. deposits dually payable in the United States.[11] But dual payability is itself not a panacea. It comes with many disadvantages to consumers, banks, and the FDIC's resolution function. Dual payability is not an optimal way to treat custody depositors and our customers have not asked to have their deposits made dually payable. We believe – particularly given the size of our foreign deposit holdings related to our custody operations – the disadvantages associated with dual payability warrant further FDIC consideration.

As a threshold matter, dual payability does not necessarily address the cross-border resolution impediments created by the U.S. depositor preference statute. It is unclear that the Proposal would be a meaningful advancement if other jurisdictions, beyond the U.K., adopt similar requirements that their citizens be treated *pari passu* with U.S. customers. As global custodians, we have a vested interest in having all of our customers treated equally. Having customers in various jurisdictions at different priority levels in the event of a resolution creates complicated operational and business issues. A related concern is present at the transactional level. For example, if one of the Custody Banks were to assume new custody depositors from another institution there may be issues with harmonizing dually payable deposits with existing operations. Similarly, from the FDIC's perspective, if a global bank with significant amounts of dually payable deposits were to fail, the FDIC would need to conduct contract-by-contract reviews to determine how customers should be treated. Given the likely strains on FDIC resources during the potential resolution of a global bank, such a granular review of deposit contracts appears unnecessarily cumbersome and may delay or impede an orderly resolution of a failed bank.

Making deposits dually payable also may increase sovereign risk for banking organizations. Section 25C of the Federal Reserve Act limits the recourse of foreign branch depositors to demand payments in the United States of deposits held overseas when actions by foreign sovereigns – or other *force majeure* – prevent payment in the depositors' home country. In effect, dual payability may eliminate the long standing Federal Reserve policy of requiring foreign depositors, and not U.S. BHCs, to bear

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[11] We do not believe there are viable options for ensuring U.K. depositors are paid *pari passu* with U.S. depositors in the resolution of a U.S. bank beyond subsidiarization, dual payability, or some ring-fencing paradigm. Additionally, while all of the Custody Banks do have existing subsidiary banks within the European Economic Area Zone, we believe that moving deposits from our U.K. branches to those entities would raise many of the same trapped liquidity and capital management problems as subsidiarization.

sovereign risks associated with the location of deposits. The Custody Banks recognize that the Proposal states it is not intended to prevent a bank from protecting itself from sovereign risk. But, there are at least two problems with that position. First, to the extent a bank seeks to protect itself from sovereign risk through contractual language, it may increase the risk of litigation either before or after insolvency. Second, it remains unclear whether, if a bank protects itself under Section 25C, the deposit will still meet all FSA requirements regarding the elimination of depositor preference.

Beyond increased sovereign risk, bank customers are also likely to see increased costs and burdens. New reserve requirement expenditures necessitated under the Federal Reserve's Regulation D and significant operational and IT investments are likely to be borne, in part, by affected depositors.

Last, we are concerned that the Proposed Rule does not fully consider whether or not dual payability actually meets the FSA criteria for parity set forth in the Consultation Paper. There would likely, by necessity, be various species of dually payable deposits. We could foresee, for instance, contracts that require foreign depositors to first make presentment at foreign offices before presenting for payment in the United States. If the FDIC finalizes the Proposal largely as is, we would respectfully request that the FDIC state clearly how dual payability would be treated in the event of a bank's insolvency. Such greater clarity, especially an unequivocal statement that dually payable deposits including Section 25C protections or requiring foreign depositors to first attempt presentment at a foreign office would be treated *pari passu* in the event a U.S. BHC is resolved, would help ensure FSA approval of dual payability plans.

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Thank you again for the opportunity to comment on matters of concern to the Custody Banks.

Should you have any questions, please feel free to contact Heather Koenig, Managing Director and Global Chief Regulatory Counsel of The Bank of New York Mellon at 212-635-7399 (e-mail: Heather.Koenig@bnymellon.com); James E. Roselle, Executive Vice President and Associate General Counsel of Northern Trust Corporation at 312-444-7565 (e-mail: jer7@ntrs.com); Simon Zornoza, Senior Vice President and Chief Regulatory Counsel of State Street Corporation at 617-664-1541.

Sincerely,

H R Koenig

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| Heather R. Koenig | James E. Roselle | Simon Zornoza |
| BNY Mellon | Northern Trust | State Street |