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Client Alert – FDIC May Not Honor Letters of Credit Issued by Failed Banks

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Since 1995, the Federal Deposit Insurance Corporation (“FDIC”) has taken the position that it may not honor unsecured letters of credit issued by financial institutions that are placed in FDIC receivership. In the recent economic downturn, the FDIC has advised commercial landlords that this policy is still in effect. As a result, landlords holding letters of credit from these banks as security deposits from tenants could find themselves unsecured. Once the issuing bank is placed in receivership the matter is out of the landlord’s hands; while it can demand that the tenant provide a replacement, it cannot draw on the existing letter of credit if the replacement is not forthcoming. Therefore, landlords holding letters of credit from tenants should actively monitor the financial health of issuing institutions to anticipate potential failures and determine whether to require replacement letters of credit or take other available steps allowed by the lease.

The FDIC will not issue any information about the financial condition of any particular financial institution, but there are private companies that publish ratings on banks or offer monitoring services that may allow landlords to remain informed of the financial status of their letter of credit issuer(s).

For landlords willing to actively monitor the ratings of financial institutions themselves, several private companies provide basic bank ratings based on public regulatory filings. These rating agencies—Standard and Poor’s ([click here](#), free registration required), Moody’s

([click here](#), free registration required), Fitch Ratings ([click here](#)), and BankRate ([click here](#))—have basic, free online ratings of the relative strength and stability of financial institutions, focusing on capital adequacy, asset quality, profitability, and liquidity. These free services may provide a cost-effective approach to remaining aware of any possible impending FDIC receivership and subsequent repudiation of a letter of credit.

For landlords seeking third-party monitoring services, some of these private rating companies actively monitor the financial health of specific banks and issue periodic reports to clients for a fee. The following are examples of such private companies and services:

- **Standard and Poor’s:** Standard and Poor’s offers RatingsDirect, a subscription ratings service that is web-based and fully customizable. A subscriber may customize a portfolio of financial institutions for more efficient monitoring. (Note that Standard and Poor’s also includes a specific “Bank Survivability Assessment”, but this rating is not useful as a tool for monitoring potential FDIC receivership, as its definition of “survivability” includes continued existence under control by a government entity, such as the FDIC.) Information and pricing for RatingsDirect may be found online ([click here](#)) or by telephone at (212) 438-7280.
- **Moody’s:** Moody’s Bank Research provides periodic analysis of the financial strength of banks, including the ability to track individual banks through weekly or bi-weekly email alerts. Information and pricing for

Moody's Bank Research may be found online ([click here](#)) or by telephone at (212) 553-1658.

- **Veribanc:** Veribanc offers a wide range of ratings reports that vary in level of detail, frequency of communication, and cost. These products range from instant ratings by phone to quarterly, in-depth research reports for specific financial institutions that coincide with bank regulatory filings. For landlords that want to monitor several institutions, the "Watch List" report addresses bank safety ratings and provides supporting data for a list of institutions provided by the client. Information and pricing for Veribanc services may be found online ([click here](#)) or by telephone at (800) 442-2657.
- **IDC Financial Publishing, Inc.:** IDC generally offers similar services to Veribanc, including one-time rankings over the telephone and in-depth research reports available on a one-time and quarterly basis. Information and pricing for IDC services may be found online ([click here](#)) or by telephone at (800) 525-5457.

In summary, to prevent the possibility of an FDIC repudiation of an existing letter of credit, it is important for landlords to anticipate receivership by monitoring the financial health of the issuer. When considering the available options, landlords must assess whether they have the willingness and ability to actively monitor ratings, without the help of periodic reports automatically issued by monitoring services. For landlords with this capability, information from the free ratings services should be sufficient to monitor the financial health of issuing institutions. Landlords without this willingness and ability should consider the third-party monitoring services as a cost-effective approach to remaining informed of the financial status of letter of credit issuers.

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For questions regarding the information contained in this advisory, or for questions about whether and to what extent existing lease language permits the demand of a replacement letter of credit if the existing letter of credit has not yet been repudiated, please contact your usual Goulston & Storrs attorney or:

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