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News Bulletin

November 23, 2008

FDIC Approves Temporary Liquidity Guarantee Program Final Rule

On November 21, 2008, the Board of the Federal Deposit Insurance Corporation (FDIC) approved a final rule for the Temporary Liquidity Guarantee Program (TLGP). The final rule provides significant changes from the interim rule, including that the FDIC guarantee on newly-issued senior unsecured debt will provide timely payment of interest and principal upon the issuing institution's failure to pay and that the guarantee is backed by the full faith and credit of the United States. The provisions of the final rule are discussed below in more detail. **All eligible entities are required to take action under the TLGP no later than 11:59 p.m. on December 5, 2008: to opt-out of either or both programs under TLGP or to report their applicable issuance cap under the debt guarantee program. Additionally, some notice provisions apply to non-participating as well as participating eligible entities.**

The TLGP was established on October 14, 2008 and all eligible entities are automatically covered by the program, unless and until they elect to opt-out. The FDIC announced the program in a joint statement with the Treasury and Federal Reserve in a coordinated effort to unfreeze inter-bank lending, encourage lending more broadly and enhance confidence in the banking system. Please see our coverage of these coordinated efforts and the current financial crisis at Financial Crisis Legal Updates and News.

Highlights of Changes from the Interim Rule

	Interim Rule	Final Rule
Debt Guarantee Program		
• **Covered Debt**	• Broad definition of newly-issued senior unsecured with certain exceptions	• Excludes short-term senior unsecured debt with a maturity of 30 days or less issued after Dec. 5 • Clarifies exclusion of any type of debt issued with another instrument; structured notes; and retail debt
• **Guarantee Payment**	• Principal and interest guarantee payment upon receivership or bankruptcy	• Payment guarantee for timely payment of principal and interest upon uncured payment default
• **Fee**	• 75 bps per annum	• Sliding scale from 50 bps to 100 bps per annum depending on maturity of debt • 10 bps surcharge for holding companies whose insured depository institutions are <50% of their assets
• **Issuance cap**	• 125% of covered debt outstanding on Sept 30th scheduled to mature by June 30, 2009; if zero – cap to be determined by FDIC	• Same rule, but if zero, cap is 2% of consolidated total liabilities as of Sept 30th • Cap calculated using debt with 30-day or less maturity even though such debt isn't guaranteed if issued after Dec 5th
• **Issuance cap**	• Applied separately for each eligible entity within a holding company structure	• Depository institution can issue up to the combined issuance cap for itself and its direct and indirect parents

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Disclosures	Required in writing	Prescribed language provided for guaranteed and non-guaranteed debt
Full faith and credit	Not addressed in interim rules	Rule provides debt is backed by "full faith and credit of the United States"
Transaction Account Guarantee Program		
Covered accounts	Excluded NOW accounts and all interest-bearing accounts	• Includes lawyer trust accounts where interest does not accrue to the account owner (IOLTA) • Includes NOW accounts with interest rates no higher than 0.50%

Temporary Liquidity Guaranty Program Overview

The TLGP consists of two programs, one to guarantee newly-issued senior unsecured debt (Debt Guarantee Program) and the second to insure the full balance in noninterest-bearing transaction accounts (Transaction Account Guarantee Program). The guarantees provided by the program have been in place since the FDIC's announcement on October 14, 2008 and all eligible entities were automatically included. Eligible entities not interested in participating are required to affirmatively opt out.

During the first 30 days no fees were assessed on eligible entities and no fees will be assessed on eligible entities that opt out. Fees accrue from November 13, 2008 for participating institutions that do not opt out, as described under "Fees for the TLGP."

Guarantees for non-participating institutions will terminate upon submission of an opt-out election. For participants, the guarantees under the Transaction Account Guarantee Program will expire on December 31, 2009 and senior unsecured debt instruments issued from October 14, 2008 through June 30, 2009 will be guaranteed through the earlier to occur of the maturity of the debt and June 30, 2012.

Affirmative Opt-Out and Election Form

All eligible entities must submit an opt-out/election form to the FDIC by 11:59 p.m., December 5, 2008.

Entities no longer interested in participating must affirmatively opt out of either or both of the Debt Guarantee Program and the Transaction Account Guarantee Program. All eligible entities within a holding company structure must make the same decision; together they can opt out of one or both programs under TLGP, or choose to remain in the programs. An eligible entity's decision to opt out of either component of the TLGP will be made publicly available. The FDIC will post on its website a list of those entities that have opted out of either or both components of the TLGP so that potential lenders and transaction account depositors can tell when an entity has taken itself out of the program. The FDIC will not, however, post a list of the participating entities. All guarantees will terminate immediately upon the filing of an opt-out election.

Participants remaining in the Debt Guarantee Program must provide issuance cap information, as described below, certified by the Chief Financial Officer, on the FDIC's election form by the opt-out date. Submission of issuance cap information will also be confirmation of the eligible entities agreement with the terms of the master agreement described below.

All opt-out elections are irrevocable, with one exception. Upon filing of an application for merger of eligible entities, the entities may request a change in status under the TLGP, for example, a request that the resulting entity opt out of the program or be a participant in the program.

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Eligible entities

Entities automatically eligible to participate include (1) FDIC insured depository institutions, (2) U.S. bank holding companies and financial holding companies with at least one operating insured depository institution subsidiary and (3) U.S. savings and loan holding companies, with at least one operating insured depository institution subsidiary, that either engage only in activities that are permissible for financial holding companies to conduct under section 4(k) of the Bank Holding Company Act of 1956 (BHCA) or had at least one insured depository subsidiary that was the subject of an application under section 4(c)(8) of the BHCA pending on October 13, 2008. FDIC-insured institutions owned by foreign entities are not eligible to participate in the Debt Guarantee Program. Additionally, an affiliate of an insured depository institution may request that its federal banking regulator recommend to the FDIC that a determination be made that the affiliate is an eligible entity. The rule describes the factors the FDIC will consider in making its determination.

An entity will automatically be an eligible entity if it satisfied the definition on or before December 5, 2008. An entity that falls within the definition after December 5, 2008 may request permission from the FDIC to participate in the TLGP. If an eligible entity ceases to be, or to be affiliated with, a chartered and operating insured depository institution, it may no longer participate in the program.

Debt Guarantee Program

The Debt Guarantee Program provides an FDIC guarantee on all newly-issued senior unsecured debt instruments issued by participants. The guarantee will cover debt issued from October 14, 2008 through June 30, 2009, and will expire upon the earliest to occur of (1) the date the issuer opts out, (2) the maturity of the debt or (3) June 30, 2012. The aggregate newly-issued senior unsecured guaranteed debt a participant may have outstanding may not exceed the issuance cap for that participant. The issuance cap, described in more detail below, is 125% of that participant's outstanding debt on September 30, 2008 that was scheduled to mature on or before June 30, 2009. The estimated amount of eligible entity qualifying senior unsecured debt outstanding as of September 30, 2008 is $1.4 trillion.

As described under "Payment of Claims" below, the FDIC guarantee covers timely payment of interest and principal upon an uncured payment default. The final rule states that the guaranteed debt is backed by the full faith and credit of the United States and has a 20% risk weighting.

Definition of Senior Unsecured Debt

Debt covered by the Debt Guarantee Program includes senior unsecured debt issued on or after October 14, 2008 through June 30, 2009. The program was initially intended to capture newly-issued senior unsecured debt regardless of its maturity. However, the final rule excludes debt with a maturity of 30 days or less, if issued after the opt-out date.

The final rule provides a non-exclusive list of senior unsecured debt instruments that are covered by the guarantee for participating institutions as well as a non-exclusive list of excluded debt. The FDIC has stated that the program "is not designed to encourage the development of or to promote innovative or complex sources of funding but to enhance the liquidity of the inter-bank lending market and senior unsecured bank debt funding." The FDIC has interpreted very narrowly "innovative or complex" debt instruments.

Senior unsecured debt means unsecured borrowing, denominated in either U.S. dollars or a foreign currency, that:

- is evidenced by written agreement (including a trade confirmation),
- has a specified and fixed principal amount to be paid in full on demand or on a date certain,
- is non-contingent and contains no embedded options, forwards, swaps or other derivatives,

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- is not by its terms subordinated to any other liability, and
- (after December 5, 2008) is issued with a stated maturity of more than 30 days.

The debt may pay interest at a fixed or floating rate, but the floating interest rate must be based on a single index of a Treasury bill rate, the prime rate or LIBOR.

Senior unsecured debt includes but is not limited to:

- federal funds purchased,
- promissory notes,
- commercial paper,
- unsubordinated unsecured notes, including zero-coupon bonds
- U.S. dollar denominated certificates of deposit owed to an insured depository institution, an insured credit union as defined in the Federal Credit Union Act or a foreign bank[1],
- U.S. dollar denominated deposits in an international banking facility of an insured depository institution owed to an insured depository institution or a foreign bank, and
- U.S. dollar denominated deposits on the books and records of foreign branches of U.S. insured depository institutions that are owed to an insured depository institution or a foreign bank.

The examples of exclusions from the definition of senior unsecured debt provided in the final rule are:

- any obligation with a stated maturity of one month,[2]
- obligations from guarantees or other contingent liabilities,
- derivatives,
- derivative-linked products,
- debt that is paired or bundled with any other security,
- convertible debt,
- capital notes,
- the unsecured portion of otherwise secured debt,
- negotiable certificates of deposit,
- deposits in foreign currency and or other foreign deposits (unless expressly included as covered senior unsecured debt),
- revolving credit agreements,
- structured notes,
- instruments that are used for trade credit,
- retail debt securities,[3]

[1] The term "foreign bank" does not include a foreign central bank or other similar foreign government entity that performs central bank functions or a quasi-governmental international financial institution such as the IMF or the World Bank. References to debt owed to an insured depository institution, an insured credit union, or foreign bank mean owed to the institution solely in its own capacity and not as agent.

[2] This recognizes that certain instruments have stated maturities of "one month," but have a term of up to 35 days because of weekends, holidays and calendar issues.

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- any funds that regardless of form are swept from individual, partnership or corporate accounts held at insured depository institutions, and
- loans from affiliates, including parents and subsidiaries and institution affiliated parties.

Further, debt will not be guaranteed if the proceeds are used to prepay outstanding non-guaranteed debt. Under the final rule, the proceeds from the issuance of FDIC-guaranteed debt may be issued to prepay other FDIC-guaranteed debt, but may not be used to prepay outstanding non-guaranteed debt.

Guaranteed Debt Issuance Cap

Under the TLGP, the FDIC will guarantee new senior unsecured debt in an amount up to 125% of the par value of senior unsecured debt outstanding as of September 30, 2008, that is scheduled to mature by June 30, 2009. For purposes of determining the issuance cap, the eligible entity should include debt with maturities of 30 days or less, even though such debt will no longer be guaranteed if issued after the opt-out date. The issuance cap should be calculated separately for each individual participating entity within a holding company structure. Each participating entity must calculate its outstanding senior unsecured debt as of September 30, 2008, and provide that information – even if the amount of the senior unsecured debt is zero - to the FDIC on the election form.

If an eligible entity did not have any senior unsecured debt (other than federal funds) outstanding on September 30, 2009, its issuance cap will be 2% of total outstanding liabilities. An affiliate of an insured depository institution that becomes an eligible entity upon application to a federal banking regulator and the FDIC, will have its issuance cap determined by the FDIC at the time it is designated an eligible entity.

On a case-by-case basis, the FDIC may grant a participating entity authority to temporarily exceed the 125% issuance cap. Based on the supervisory information available to it, the FDIC also may restrict the authority of an entity to issue guaranteed debt to a level below the 125% issuance cap.

An insured depository institution may combine its issuance cap with that of a direct or indirect parent participant. Participants interested in combining issuance caps are required to make a written request to the FDIC and the participant parent entity. Any use of a parent's capacity to issue guaranteed debt will reduce the amount available to the parent under its cap.

If an eligible entity does not opt out, all newly-issued senior unsecured debt, up to the issuance cap, will become guaranteed as and when issued. Generally, only after the participant has issued guaranteed debt up to the cap amount may it issue non-guaranteed debt. However, a participant may issue long-term non-guaranteed debt at any time if it has elected to participate in, and is paying the special fee for, the long-term non-guaranteed debt program described below.

Long-Term Non-Guaranteed Debt Program for Participating Entities

If a participating entity wants to have the option of issuing long-term non-guaranteed senior unsecured debt at any time, and before issuing guaranteed debt up to its cap amount, it can elect to do so through *FDICconnect* on its election form. Elections are required by the opt-out date. Upon making an election, the participant will be required to pay a nonrefundable fee. Long-term non-guaranteed senior unsecured debt must mature *after* June 30, 2012.

[3] The FDIC's updated Frequently Asked Questions clarifies that retail debt securities are those debt instruments the marketing of which is targeted to retail investors, typically with small denominations. It does not include debt securities purchased in the secondary market by retail investors if the initial marketing was targeted to non-retail investors.

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Master Agreement [posted to Financial Crisis Legal Updates and News as of Monday, November 24]

Participants in the Debt Guarantee Program are required to execute a master agreement no later than the opt-out date and provide a copy to the FDIC no later than five days thereafter. The master agreement is required to facilitate the payment guarantee by the FDIC and includes the following key terms:

- the participant is required to provide notice, within one business day, of any failure to pay interest on or principal of any indebtedness,
- governing documents of guaranteed debt must include the following required terms:
  - appointment of a representative that will make claims for payment under the guarantee,
  - requiring the representative to give the FDIC notice within one business day of any payment default by the participant,
  - authorizing the assignment to the FDIC of the debt instrument when the FDIC commences making guarantee payments,
  - requiring surrender of the debt instrument if the FDIC if it elects to repay the debt in full while making guarantee payments, and
  - requiring FDIC consent to any amendment to the debt instrument that modifies principal, interest, payment, default or ranking,
- for guaranteed debt evidenced solely by a trade confirmation, the participant must use commercially reasonable efforts to have the holder of the debt execute a written agreement that includes the required terms,
- no document governing guaranteed debt may provide for automatic acceleration of debt upon a default by the participant while the FDIC guarantee is in effect or while guarantee payments are being made by the FDIC (default is not limited in this provision to payment defaults), and
- a representation by the participant that any document filed with or furnished to the Securities and Exchange Commission was materially accurate.

Participants will be required to comply with the provisions of the master agreement in all issuances from and after December 6, 2008.

Notice Requirements

Notices to the FDIC. Participants are required, following the opt-out date, to notify the FDIC through *FDICconnect* of each issuance of guaranteed debt. The Chief Financial Officer (or equivalent officer) must certify to the FDIC that the issuance is within the issuance cap. Upon notification, the FDIC will generate a fee invoice for the related guaranteed debt.

Notices to Counterparties. Participants in the Debt Guarantee Program are required to use the final rule's prescribed disclosure language in all written materials provided to lenders or creditors when issuing *either* guaranteed or non-guaranteed debt. A participant may be issuing non-guaranteed debt either as part of the long-term non-guaranteed debt program or for issuances after the participant has reached its issuance cap. The disclosures are only required with respect to debt that is eligible for the guarantee; the participant does not have to provide disclosure when issuing ineligible debt.

The deadline for complying with the notice requirements is December 19, 2008. Prior to that date, the final rule requires that participants provide adequate disclosures in a commercially reasonably manner. In addition, issuers of guaranteed and non-guaranteed debt instruments will need to assess the materiality of the FDIC guarantee, or its absence, in light of applicable securities law liabilities when evaluating what disclosures to make.

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The Transaction Account Guarantee Program

Deposits in a participant's noninterest-bearing deposit transaction accounts will be fully guaranteed by the FDIC, regardless of the amount on deposit. This guarantee is separate from and in addition to the coverage provided under the FDIC's general deposit insurance regulations. The estimated amount of uninsured non-interest bearing transaction account deposits, prior to the TLGP, is between $400 and $500 billion.

This coverage became effective on October 14, 2008, and will continue through the earlier of an eligible entity's opt-out date and December 31, 2009.

Definition of "Non-interest bearing Transaction Account"

A "noninterest-bearing transaction account" is defined as a transaction account, such as a corporate checking account, that allows for an unlimited number of deposits and withdrawals at any time. The final rule notes that depository institutions sometimes waive fees or provide fee-reducing credits for customers with checking accounts. Such account features will not prevent an account from qualifying under the Transaction Account Guarantee Program as a noninterest-bearing transaction account, as long as the account otherwise satisfies the definition.

Depository institutions may sweep noninterest-bearing transaction account balances into other accounts. Sweep accounts will generally be handled the same way they would be in a depository institution failure; the FDIC will guarantee the account based on a determination of where the money is at the close of the business day. If cash in a noninterest-bearing deposit account is swept into an interest bearing account during the day (before the close of business), the funds in the interest bearing account will not be insured. If the funds are swept into any other noninterest-bearing transactional account or a noninterest-bearing savings account, however, the deposits in that account will be covered by the guarantee.

Two limited exceptions have been made to the requirement that the account be noninterest-bearing. First, interest-bearing lawyers trust accounts, generally referred to as IOLTA accounts, are deemed to be noninterest-bearing accounts covered by the guarantee. These are accounts opened by attorneys to hold client funds. The interest on these accounts is paid, not to the attorney or client, but to a state fund for law-related public service programs such as providing legal aid to the poor. Second, negotiable order of withdrawal (NOW) accounts that have an interest rate at or below 0.50% will be considered noninterest-bearing and be covered by the guarantee. Determination of whether or not an account in noninterest-bearing will be based on the account agreement, not whether or not interest accrues on an account's deposits.

Notice Requirements

Each eligible entity must prominently disclose ***whether or not*** it is participating in the Transaction Account Guarantee Program. Disclosures must be posted in the lobby of the participant's main office, in each domestic branch and on its website if it offers internet deposit services. Sample disclosures have been provided by the FDIC and the final rule provides that disclosure be in simple, readily understandable text. The disclosure must clearly state whether or not covered noninterest-bearing transaction accounts are guaranteed in full by the FDIC.

If a participant uses sweep arrangements or takes other actions that result in funds in a noninterest-bearing transaction account being transferred to or reclassified such that they are no longer guaranteed in full under the program, the participant must disclose those actions to the affected customers and clearly advise them in writing that such actions will void the transaction account guarantee. The FDIC has not provided sample disclosures for sweep accounts because these arrangements vary widely between institutions, but requires that the disclosure be accurate, clear and in writing.

The deadline for compliance with the notice requirements is December 19, 2008. Prior to that date, the final rule requires eligible entities provide adequate disclosures in a commercially reasonable manner.

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Fees for the TLGP

For the first 30 days of the program, from October 14 through November 12, 2008, when all eligible entities were automatically covered by the TLGP, there were no assessments of fees. Fees will be assessed beginning November 13, but only for eligible entities that do not opt out of the program. No entity that opts out of a program will be assessed a fee for that program.

The fees are expected to fully fund the TLGP, with no reliance on taxpayer funding. All fees and assessments will be held by the FDIC in a separate account and will not be included in the Deposit Insurance Fund. If the fees and assessments collected under the TLGP are insufficient to cover the cost of the program, the FDIC will impose an emergency special assessment on insured depository institutions. Because the special assessment is required by statute to be based on the financial institutions' liabilities, rather than deposits, larger financial institutions will bear the greater burden of the assessment as they typically maintain a higher proportion of liabilities than smaller financial institutions. All financial institutions whose deposits are insured by the FDIC will be subject to any special assessment, irrespective of their participation in the TLGP. Many community banks and banks not owned by holding companies expressed concern during the rulemaking comment process that upon a shortfall, insured depository institutions would bear a disproportionate burden because holding companies would not be subject to the special assessment. As a result of these comments, the FDIC created a surcharge for certain holding companies participating in the Debt Guarantee Program, as described below. On the other hand, if, at the termination of the program, there are excess funds remaining, they would be deposited in the Deposit Insurance Fund.

Fees for entities that do not opt-out of the Debt Guarantee Program:

A fee will be assessed on (1) senior unsecured debt, other than overnight debt, issued from October 14 through December 5 and still outstanding on December 5 and (2) senior unsecured debt issued from December 6, 2008 through June 30, 2009.

- Guaranteed debt with a maturity of 180 days or less: 50 basis points per annum
- Guaranteed debt with a maturity of 181-364 days: 75 basis points per annum
- Guaranteed debt with a maturity of 365 days or greater: 100 basis points per annum
- A 10 basis point per annum surcharge will be assessed on a participating entity that is an affiliate of one or more insured depository institutions (generally holding companies), if those affiliated depository institutions represent less than 50% of the consolidated assets.
- The applicable fees will be doubled for all outstanding guaranteed debt if a participating entity issues debt represented as guaranteed in excess of its issuance cap. The FDIC may reduce the penalty fee upon a showing of good cause.

The fee will be assessed from the issuance date through the earlier of the maturity date or the termination of the guarantee, June 30, 2012. Invoices will be generated through *FDICconnect* once a participating institution notifies the FDIC of its issuance of guaranteed debt.

If a participating entity elects to participate in the long-term non-guaranteed debt program under the Debt Guarantee Program, it will be required to pay a fee of 37.5 basis point times the issuance cap. The nonrefundable fee will be collected by the FDIC in six equal monthly installments. As the participating entity issues guaranteed debt, the amounts invoiced for guaranteed debt will be offset by the fees paid for the long-term non-guaranteed debt program.

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Fees for entities that do not opt-out of the Transaction Account Guarantee Program:

Fees for the program will be assessed and payable based on the quarter-end Call Report balances in covered accounts.[4] The fee will be 10 basis points per annum on all covered deposits in excess of the existing deposit insurance limit of $250,000. The first fee will be based on the period from November 13 through December 31, 2008. Assessments for this program will be collected along with the participating entity's quarterly deposit insurance payment and will be in addition to an institution's risk-based assessment imposed under current regulations.

Payment of Claims

Debt Guarantee Program

Under the Guaranteed Debt Program, upon the uncured failure of the issuer of guaranteed debt to pay interest or principal, the FDIC will make the required payment. This payment guarantee provided in the final rule is a change from the interim rule that had provided for a payment only upon the receivership of an insured depository institution or bankruptcy of a holding company. If the FDIC is paying interest and principal on debt that remains outstanding after June 30, 2012, it will have the right to elect to make a final payment of all outstanding principal and interest due through the date of final payment, without incurring a prepayment penalty.

Upon an uncured payment default, a demand for payment to the FDIC must be made by an authorized representative of all of the holders of the defaulted debt or an individual debtholder. For guaranteed debt issued on or after December 6, 2008, the participant is required under the terms of the master agreement to appoint a representative for such purposes. Individual holders of the debt will have the option to represent themselves. Demands must be made within 60 days of the default if made by an authorized representative or within 90 days of the default if made by an individual debtholder. Once guarantee payments commence, the representative and any individuals will be required to assign their debt to the FDIC to collect against the participant. The participant will be obligated to reimburse the FDIC for its guarantee payments, interest on any unreimbursed amounts at the non-default interest rate plus one percent and for all reasonable out-of-pocket expenses of the FDIC.

Transaction Account Guarantee Program

The payment and claims process for satisfying claims under the Transaction Account Guarantee Program generally will follow the procedures prescribed for deposit insurance claims pursuant to current regulations, and the FDIC will be subrogated to the rights of depositors against the institution pursuant to current statutory requirements.

Authorization and Supervision

The TLGP was established under the FDIC's authority under the Federal Deposit Insurance Act to prevent a "systemic risk." The FDIC is authorized to take action when Treasury, upon a recommendation of the boards of the Federal Reserve and the FDIC and in consultation with the President, makes a determination of comparable systemic risk.

The final rule makes clear that the FDIC has the primary authority over the TLGP. While the FDIC will work with an eligible entity's primary federal regulator, the FDIC will make all final decisions regarding parameters, eligibility and continuing participation in the program. Participation in the TLGP constitutes consent and acknowledgment by the eligible entity of the FDIC's authority, as well as permission to the FDIC to permit on-site reviews as needed to determine compliance with the program.

[4] As reported on the participating entity's Consolidated Reports of Condition and Income, Thrift Financial Report or Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks.

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Additional Information

Additional information may be found on the FDIC's dedicated TLGP web site at www.fdic.gov\ tlgp and documents will be available to eligible entities through *FDICconnect*.

Please click here to visit our Financial Crisis Legal Updates and News webpage.

Please click here to read our TLGP cheat sheet.

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