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News Bulletin

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FDIC Issues Interim Rule to Implement Temporary Liquidity Guarantee Program

Provides Framework and Operating Details

On October 23, 2008, the Board of Directors of the Federal Deposit Insurance Corporation (the "FDIC") announced that it had approved an interim rule under the FDIC's systemic risk exception process (the "Interim Rule") to govern its newly created Temporary Liquidity Guarantee Program (the "TLGP").[1] The Interim Rule is effective immediately but comments will be taken for the 15-day period after publication in the Federal Register.

On October 14, 2008, the FDIC announced the creation of the TLGP as part of the larger and continuing government effort to strengthen confidence and encourage liquidity in the nation's banking system. The TLGP is a voluntary and time-limited program that will be funded through special fees without reliance on taxpayer funding. Subject to the conditions set forth in the Interim Rule, the program consists of two basic components: a temporary guarantee of newly issued senior unsecured debt (the "Debt Guarantee Program") and a temporary unlimited guarantee of funds in noninterest-bearing transaction accounts at FDIC-insured institutions (the "Transaction Account Guarantee Program"). It is also likely that financial institutions participating in the TLGP may participate in the Capital Purchase Program ("CaPP") of the Treasury Department's Troubled Asset Relief Program ("TARP"). [2]

The Interim Rule[3] provides further detail on the operation of the TLGP, and this Client Alert expands upon and supersedes the discussion contained in our earlier Client Alert about the TLGP.[4] Further, some of the provisions of the Interim Rule are different from those discussed by the FDIC in its informational briefings (the "Technical Briefings") and it is important to review the rule carefully. We have noted certain of those changes in this Client Alert.

FDIC Control

The Interim Rule makes clear that the FDIC has the primary authority over the TLGP. While the FDIC will work with an eligible institution'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 institution of the FDIC's authority, as well as permission for the FDIC to permit on-site reviews as needed to determine compliance with the program.

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[1] http://www.fdic.gov/news/news/press/2008/pr08105.html.
[2] See our Client Alert, "Update to Treasury's Capital Purchase Program, http://www.mofo.com/news/updates/files/081021TreasuryUpdate.pdf. Financial institutions and their advisors should consider that Alert together with this Client Alert, particularly if they are considering how the CaPP and TLGP are likely to work together.
[3] http://www.fdic.gov/news/board/TLGPreg.pdf.
[4] See our Client Alert, "New Liquidity and Capital Alternatives for Financial Institutions: Treasury's TARP Capital Purchase Program; FDIC's Temporary Liquidity Guaranty Program," http://www.mofo.com/news/updates/files/081016NewLiquidity.pdf.

Eligible Institutions

Eligible entities able to participate in the TLGP include any FDIC-insured depository institution, any U.S. bank holding company, including financial holding companies, and any U.S. savings and loan holding company that either engages 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 has at least one insured depository institution subsidiary that is the subject of an application that was pending on October 13, 2008, pursuant to Section 4(c)(8) of the BHCA. The TLGP is not available for foreign banks. The FDIC has also reserved the right to extend this protection to an affiliate of an eligible entity on a case-by-case basis as determined by the FDIC after a written request and positive recommendation made by the appropriate Federal banking agency. No holding company can continue its participation in the TLGP unless it has a chartered, and operating insured depository institution.

Affirmative Opt-Out

All eligible institutions are automatically enrolled in the TLGP for the 30 days from October 14 through November 12, 2008 at no cost. On or before November 12, 2008, eligible entities must inform the FDIC whether they will opt out of either or both portions of the TLGP. All eligible entities within a U.S. bank holding company or a U.S. savings and loan holding company structure must make the same decision regarding continued participation in each guarantee program.[5] Thus, the costs to the financial institution of participation in the TLGP must be carefully considered. 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 possible lenders and transaction account depositors can tell when an entity has taken itself out of the program.

If an eligible entity chooses to opt out of the debt guarantee portion of the TLGP, the FDIC's debt guarantee will terminate at the earlier of 11:59 p.m. EST on November 12, 2008 or at the time of the eligible entity's opt out decision, regardless of the term of the instrument.

After November 12, 2008, participating entities will be charged fees as further described under "Fees for the TLGP Program" below.

Debt Guarantee Program

Definition of debt eligible to participate

Under the Interim Rule, for eligible entities that do not opt out, the Debt Guarantee Program will guarantee all newly issued senior unsecured debt issued on or after October 14, 2008, through and including June 30, 2009. While the eligible debt must be issued on or before June 30, 2009, for debts maturing after that date, the FDIC will provide the guarantee coverage for three years beyond that date, until June 30, 2012, even if the eligible debt's maturity date is after June 30, 2012. According to the Interim Rule, this final effective date for coverage is firm; coverage will expire on June 30, 2012, regardless of whether the liability has matured at that time.

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

- is evidenced by written agreement;
- has a specified and fixed principal amount to be paid in full on demand or on a date certain;
- is noncontingent; and
- is not, by its terms, subordinated to any other liability.

[5] This "all-or-none" approach is different from the proposals discussed in the Technical Briefings.

As indicated in the Interim Rule, senior unsecured debt includes but is not limited to:

- federal funds purchased;
- promissory notes;
- commercial paper;
- unsubordinated unsecured notes;
- certificates of deposit standing to the credit of a bank;
- bank deposits in an international banking facility ("IBF") of an insured depository institution; and
- Eurodollar deposits standing to the credit of a bank.[6]

Senior unsecured debt does not include, for example, obligations from guarantees or other contingent liabilities; derivatives; derivative-linked products; debt paired with any other security; convertible debt; capital notes; negotiable certificates of deposit; deposits in foreign currency; or Eurodollar deposits that represent funds swept from individual, partnership or corporate accounts held at insured depository institutions. It also does not include the unsecured portion of secured debt.[7] It should be noted that the FDIC has excluded most of the securities that financial institutions issue as part of their Tier 1 issuances, which may result in an inconsistency with the CaPP because a financial institution should be motivated to issue Tier 1 replacement capital to redeem a portion of the Treasury's common stock warrant that is part of the CaPP.

Further, debt will not be guaranteed if the proceeds are used to prepay outstanding debt or if the debt is extended to an insider of the eligibility entity or an affiliated entity or to the affiliated entity itself.[8]

All senior unsecured debt issued during the initial 30-day period by the participating entity will become guaranteed debt as and when issued. Thereafter, eligible entities that do not opt out will be unable to select which newly issued senior unsecured debt is guaranteed debt as they issue such debt.9

The Debt Guarantee; Limitations on Amount

Under the TLGP, the FDIC will guarantee new senior unsecured debt in an amount up to 125 percent of the par or face value of senior unsecured debt, excluding debt extended to affiliates, outstanding as of September 30, 2008, that is scheduled to mature by June 30, 2009. The maximum guaranteed amount will be calculated separately for each individual participating entity within a holding company structure. On a case-by-case basis, the FDIC may grant a participating entity authority to temporarily exceed the 125 percent limitation. Based on the supervisory information available to it, the FDIC may also restrict the authority of an entity to issue guaranteed debt to a level below the 125 percent limitation. Under procedures still to be formally announced, the FDIC will require that each participating entity 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. If an eligible entity had no senior unsecured debt prior to September 30, 2008, the FDIC will consider the circumstances of the eligible entity and may determine an alternate threshold calculation.

If an eligible entity does not opt out, all newly issued senior unsecured debt up to the maximum amount will become guaranteed as and when issued. Participating entities are prohibited from issuing guaranteed debt in excess of the maximum amount for the institution. Participating entities are also generally prohibited from issuing

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[6] The term "bank" is defined, for purposes of the definition of senior unsecured debt, to mean an insured depository institution or a depository institution regulated by a foreign bank supervisory agency.
[7] This provision is different from the FDIC's position in the Technical Briefings.
[8] The exclusion of intercompany debt is different from the FDIC's position in the Technical Briefings.
[9] This provision is different from the FDIC's position in the Technical Briefings.

non-guaranteed debt until the maximum allowable amount of guaranteed debt has been issued.[10] A participating entity can then issue non-guaranteed debt in any amount and for any length of maturity.

Notice Requirements

If an eligible entity remains in the Debt Guarantee Program of the TLGP, it must clearly disclose to interested lenders and creditors, in writing and in a commercially reasonable manner, what debt it is offering and whether the debt is guaranteed under this program. Debt guaranteed by the FDIC under the Debt Guarantee Program must be clearly identified as "guaranteed by the FDIC."

A participating entity may not represent that its debt is guaranteed by the FDIC if it does not comply with the rules governing the Debt Guarantee Program. If the issuing entity has opted out of the Debt Guarantee Program, it may no longer represent that its newly issued debt is guaranteed by the FDIC. Similarly, once an entity has reached its 125 percent limit, it may not represent that any additional debt is guaranteed by the FDIC, and must specifically disclose that such debt is not guaranteed.

The Transaction Account Guarantee Program

The Interim Rule details the parameters of the guarantee temporarily granted for funds held at FDIC-insured depository institutions in noninterest-bearing transaction accounts. This coverage became effective on October 14, 2008, and will continue through December 31, 2009 (assuming that the insured depository institution does not opt out of this component of the TLGP). In addition, the Interim Rule clarifies that this guarantee is in addition to and separate from the coverage provided under the FDIC's general deposit insurance regulations.

Definition of "Noninterest-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 Interim 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.

Accounts excluded from the definition of "noninterest-bearing transaction account" include negotiable order of withdrawal ("NOW") accounts and money market deposit accounts ("MMDAs"). If the funds in an account are at any point swept into an interest-bearing account, the interest-bearing account does not qualify for a guarantee under the Transaction Account Guarantee Program. In addition, funds swept into interest-bearing non-transaction accounts, such as savings accounts, are not covered, but where funds are swept from a noninterest-bearing transaction account to a noninterest-bearing savings account, they are covered even in the savings account. Funds swept into an interest-bearing account will still be insured under the FDIC's general deposit insurance regulations.

Notice Requirements

If an eligible entity remains in the Transaction Account Guarantee Program, the participating entity must prominently disclose in writing at its main office and at all branches at which deposits are taken its decision to participate in or opt out of the Transaction Account Guarantee Program. The disclosure must clearly state whether or not covered noninterest-bearing transaction accounts are fully insured by the FDIC. If the institution uses sweep arrangements or takes other actions that result in funds in a noninterest-bearing transaction account being

[10] If a participating entity wants to have the option of issuing certain non-guaranteed senior unsecured debt before issuing the maximum amount of guaranteed debt, it can elect to do so through FDIC*connect* on or before November 12, 2008. Election of this option would require a participating entity to pay a nonrefundable fee in exchange for which it will be able to issue, at any time and without regard to the cap, non-guaranteed senior unsecured debt with a maturity date after June 30, 2012.

transferred to or reclassified as an interest-bearing account or a non-transaction account, the institution also must disclose those actions to the affected customers and clearly advise them in writing that such actions will void the transaction account guarantee.

Fees for the TLGP

Debt Guarantee Fees

Beginning on November 13, 2008, any eligible entity that has not chosen to opt out of the Debt Guarantee Program will be assessed fees for continued coverage. All eligible debt issued from October 14, 2008 (and still outstanding on November 13, 2008) through June 30, 2009, will be charged an annualized fee equal to 75 basis points multiplied by the amount of debt issued, and calculated for the maturity period of that debt or June 30, 2012, whichever is earlier. The fee charged will take into account that no fees will be charged during the first 30 days of the program. If any participating entity issues eligible debt guaranteed by the Debt Guarantee Program, the participating entity's assessment will be based on the total amount of debt issued and the maturity date at issuance. If the guaranteed debt is ultimately retired before its scheduled maturity, fees will not be refunded.

If a participating entity should issue debt identified as "guaranteed by the FDIC" in excess of the limit established by the FDIC, it will have its assessment rate for guaranteed debt increased to 150 basis points on all outstanding guaranteed debt, and the participating entity and its institution-affiliated parties will be subject to enforcement actions, including the assessment of civil money penalties, as appropriate.

Transaction Account Guarantee Fees

Beginning on November 13, 2008, insured depository institutions that have not opted out of the Transaction Account Guarantee Program will be assessed on a quarterly basis an annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of $250,000. Under the Interim Rule, the FDIC will collect such assessments at the same time and in the same manner as it collects an institution's quarterly deposit insurance assessments according to the current regulations. Assessments associated with the Transaction Account Guarantee Program will be in addition to an institution's risk-based assessment imposed under current regulations.

Insufficient Fees

Under the Interim Rule, the FDIC will impose an emergency special assessment on insured depository institutions if the fees and assessments collected under the TLGP are insufficient to cover any loss incurred as a result of the TLGP. Because the special assessment is required to be based on the financial institutions' liabilities, 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 guaranteed by the FDIC will be subject to any special assessment, irrespective of their participation in the TLGP. In addition, if at the conclusion of these programs there are any excess funds collected from the fees associated with the TLGP, the funds will remain as part of the Deposit Insurance Fund.

Payment of Claims

Pursuant to the Interim Rule, the FDIC will make every effort to handle guarantee claims expeditiously. The FDIC is specifically requesting suggestions for ways in which the claims process might be modified to speed payment without putting the FDIC at undue risk. It should be noted that the guaranty provided by the TLGP is unlike a traditional corporate guaranty because payment is made only if the failure of the depository institution or if the holding company files for bankruptcy.

When a holding company files for bankruptcy protection, the FDIC will make payment to the debt holder for the principal amount of the debt and contract interest accrued up to the date of the filing of a bankruptcy petition in respect of the issuing institution. In addition, the FDIC will pay interest at the 90-day T-Bill rate if there is a delay in payment beyond the next business day after the date of the bankruptcy filing. The FDIC will be subrogated to the rights of any creditor it pays under the program.

The Interim Rule also sets forth the process for payment and recovery under the Transaction Account Guarantee Program. Under the Interim Rule, the FDIC's obligation to make payment, in its capacity as guarantor of deposits held in noninterest-bearing transaction deposit accounts, arises upon the failure of a participating federally insured depository institution. The payment and claims process for satisfying claims under the Transaction Account Guarantee Program generally follows 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.

Comments

Banking institutions and others may wish to comment on the Interim Rule and its application. The comment period expires 15 days after publication of the Interim Rule in the Federal Register. The extent of any revision to the Interim Rule in response to comments or the issuance of additional guidance on operation of the TLGP is not currently known.

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