

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments
550 17th Street, N.W.
Washington, DC 20429

March 19, 2009

RIN # 3064-AD37

Dear Sir,

UBS appreciates the opportunity to comment on the Interim Rule proposed on February 27, 2009 (the Interim Rule), modifying the Temporary Liquidity Guarantee Program (TLGP) as in effect under the Final Rule promulgated on November 26, 2008 (the Final Rule) to include certain issuances of mandatory convertible debt (MCD).

UBS Investment Bank is one of the world's leading investment banking and securities firms, providing a full range of products and services to corporate and institutional clients, governments, financial intermediaries and alternative asset managers.

While UBS is supportive of expanding the products offered under the TLGP and accessing the convertible investor base, we would suggest that the FDIC consider the following issues:

1. Clarifying the extent of the FDIC's guarantee as it relates to MCD;
2. Modifying the guarantee program to enhance its attractiveness to issuers and investors;
3. Permitting conversion of any guaranteed convertible debt into the common shares of an affiliate (for example, a Bank Holding Company); and
4. Addressing the regulatory capital treatment of the instruments.

We believe addressing the above comments will offer issuers of securities guaranteed under the TLGP more flexibility in obtaining long-term funding and reducing the amount of FDIC-guaranteed debt likely to require rollover in 2012.

Based on discussions which we have had with potential issuers and investors, we have heard two messages very clearly. First, investors will need more clarity as to the nature of the guarantee which is being applied to the MCD before they are willing to give it any material value. Second, issuers are looking for greater clarity

as to the likely benefits for them in issuing MCD under this program. Specific areas in which this can be addressed are with respect to regulatory capital treatment, tax-deductibility, pricing, and market capacity. The last two of these will be a function of the nature of the guarantee.

It is on the basis of these points that we are making our proposals herein.

Clarifying the guarantee

Under the Interim Rule, qualifying MCD "must provide in the debt instrument for the mandatory conversion of the debt into common shares of the issuing entity on a specified date that is on or before June 30, 2012 (unless the issuing entity fails to timely make any payment required under the debt instrument, or merges or consolidates with any other entity and is not the surviving or resulting entity.)" The Interim Rule also specified that "For purposes of mandatory convertible debt, principal payment shall be limited to amounts paid by holders under the issuance." Under the Final Rule, "[u]pon the uncured failure of a participating entity to make a timely payment of principal or interest as required under an FDIC-guaranteed debt instrument, the FDIC will pay the unpaid principal and/or interest."

In our view, these provisions of the Interim Rule and Final Rule create uncertainty around what elements of the mandatory convertible are guaranteed, as well as what could trigger a payment under the guarantee.

We see at least three potential approaches which the FDIC could take, and provide herein our thoughts as to the likely market impact of each approach, concluding with the option we believe would be most attractive to the investor community:

1. FDIC Guarantee of Interest Payments

The FDIC will make the investor whole for any payment of cash (i.e., interest) during the life of the instrument, as well as making the investor whole for the value of the shares which they would be due to receive at maturity, if cash payments or share delivery does not take place according to the terms of the MCD.

We believe that this approach would offer only a small improvement over what issuers could currently achieve in the market without a guarantee, as investors would still be subject to losing most or all of their investment in the event of the share price of the issuer declining substantially between issuance and mandatory conversion into shares at maturity.

2. FDIC Guarantee of Interest Payments, plus Principal in a Default

The FDIC will pay to the investor the initial issue price ("amounts paid by the holders under the issuance") plus any accrued but unpaid interest, if cash payments or share delivery does not take place according to the terms of the MCD.

We believe that this approach offers slightly more to investors than the first approach, as a missed payment would result in full recovery of the investors' capital. However, if an issuer performs on its obligations, but its share price drops, the investors would suffer the same losses as in the first approach.

3. FDIC Guarantee of Interest Payments and Cash Top-Up on Conversion

At maturity the MCD would, require the issuer to deliver a number of shares based on the conversion price, and in addition make a cash payment equal to the amount by which the value of those shares falls short of the initial issue price (if any), i.e. a cash top-up. In this case the FDIC would be guaranteeing the coupon payments and the shortfall at maturity in the event of any cash payments are not made.

We believe that, of the three approaches we have considered, this one would be the most attractive to investors, as well as offering the lowest interest rate for the issuers, as investors would know that their initial investment is going to be recouped in all cases (as it is in the TLGP's current form). From the perspective of the market, a guarantee in this form should make the MCD saleable to the widest group of investors, minimize interest costs for issuers, and likely attract the greatest amount of investment into the program for all potential issuers. At the same time, it reduces the potentially required refinancing at maturity to only the shortfall between the issue price and the value of the shares upon mandatory conversion. This would in many ways be similar to extending the guarantee to include optional convertibles, which we discuss in the next section.

Potential structural enhancements

We believe there are a number of structural changes which could be included in the TLGP with respect to convertible debt which would make the program more effective for issuers or attractive for investors. We outline two prospective structures in the following paragraph which we think have potentially significant value. We also believe that one of the main

1. Extending the guarantee to include optional convertibles

Consistent with the FDIC's goal to provide more flexibility for participant entities in obtaining funding and reducing the amount of FDIC guaranteed debt likely to require rollover in mid-2012, if the FDIC does not wish to follow the third approach (referenced earlier) with respect to its guarantee of MCD we suggest expanding the proposed guarantee to include optionally-convertible senior unsecured debt.

Optional convertible securities have comprised the largest component of the public convertible market since January 1, 2004, with approximately \$361 billion of securities issued. We believe this market offers an attractive and flexible capital source for issuers participating in the TLGP. At maturity of an optional convertible security, the security pays off the greater of the principal amount and value of the underlying stock based on the conversion price. In general, issuers pay less interest on these securities than they would under the straight bond equivalent in exchange for offering investors the potential to participate in the appreciation of the underlying stock. In recent transactions, the terms of the security permit issuers to settle the maturity obligation in cash, shares, or a combination thereof. We believe the features of optional convertible securities would result in lower cash servicing costs while still achieving a reduction in refinancing risk.

As a result of the potential increased demand and more attractive terms for the issuers, we believe that the FDIC should consider extending its guarantee under the TLGP to include senior unsecured debt that converts, at the option of the holder, into common stock of the issuer at maturity of the security.

2. Expanding the definition of "senior unsecured debt" to permit packaging or bundling certain other securities

Of the \$438 billion of securities have been issued by US listed issuers in the public convertible market since January 1, 2004, mandatory convertible securities comprise only 18% of the total – approximately \$77 billion. Bank issuers have historically issued these securities as they provide, among other things, efficient equity credit from rating agencies, regulatory capital treatment, and in some instances, tax deductibility and coupon deferability. Investors have been attracted to these securities for their yield (generally substantially higher than the common dividend) and participation in underlying share price appreciation. However, there has been limited issuance of mandatory securities by financial institutions in the public market since mid-2008.

Nearly all of the mandatory convertible issuance in the US has been in the form of mandatory convertible preferred stock or mandatory equity units (comprised of a forward contract to purchase common stock and underlying senior debt collateral) rather than being in the form of mandatory convertible debt. In addition, under the current Interim Rule, MCD issued under the TLGP is likely to be deemed a "disqualified debt instrument" under Section 163(l) of the Internal Revenue Code, precluding the deduction of interest paid thereon for tax purposes. These factors may limit the attractiveness of MCD to issuers under the TLGP.

The FDIC should consider expanding the definition of "senior unsecured debt" to permit bundling or packaging of FDIC-guaranteed senior unsecured debt with a derivative or other security, so long as such bundling or packaging creates a security which in its entirety would meet the requirements of a MCD permitted under the TLGP. In addition to creating a security more familiar to potential investors, allowing issuers to bundle or package FDIC-guaranteed debt with a forward purchase contract (creating a qualifying mandatory equity unit) should allow these issuers to achieve tax deductibility. We believe that the ability to achieve tax deductibility would create a strong incentive for issuers to take advantage of the flexibility proposed by the Interim Rule.

Conversion into shares of affiliates

As currently proposed, the Interim Rule would only permit MCD that "mandates conversion of the debt into common shares of the issuing entity." This restriction would effectively restrict issuance of MCD under the TLGP by wholly-owned subsidiaries of a publicly-listed parent company (for example, a FDIC-insured bank owned by a Bank Holding Company).

To address this issue, we would recommend that any convertible debt (whether MCD or optional convertible debt, including any derivative bundled or packaged with guaranteed senior unsecured debt) be exchangeable or exercisable only for common stock of the issuer or any affiliate thereof, provided that, with respect to any security of an affiliate, such security is registered with the Securities and Exchange Commission and admitted to trading on a national securities exchange at the time of issuance under the TLGP. We further believe this restriction would limit the complexity of available funding structures, thus addressing the FDIC's concern that the TLGP not be used to encourage innovative or exotic securities.

Regulatory capital treatment

In the February 27, 2009 meeting of the FDIC's board, a question was asked as to whether the MCD issued under this program would qualify as Tier 1 capital, and the response was that it would not. Based on our

analysis of the proposed Interim Rule, we would agree that in its current form the instrument is unlikely to be treated as Tier 1 capital for the issuer.

In the past, when banks have issued mandatory convertibles, they have almost always been structured to achieve Tier 1 capital. Without achieving such capital treatment, we believe that banks have limited incentive to issue the MCD under this program, as they would need to pay an interest rate which reflects the equity-like risks inherent in the structure without achieving the capital benefits of issuing equity.

To make the MCD valuable to issuers, we would encourage the FDIC to work with the Federal Reserve to determine whether there is a way in which the MCD under this program could achieve Tier 1 capital treatment.

We very much appreciate the opportunity to provide the foregoing comments, and we hope the FDIC will give them due consideration. If you would like to discuss any comments that we have made please do not hesitate to contact Gary Howe or Thomas Fox at 212-821-2100.

Yours Sincerely,

UBS Securities LLC



to
Thomas B. Fox, Jr
Head of Global Capital Markets,
Americas



Gary D. Howe
Co-Head of Financial Institutions
Group, Americas