February 27, 2009

MEMORANDUM: The Board of Directors

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SUBJECT: Interim Rule Providing for Modification of Temporary Liquidity Guarantee Program to Guarantee Mandatory Convertible Debt

I. SUMMARY OF RECOMMENDATIONS

Staff recommends that the Board adopt and authorize publication in the *Federal Register* of the attached proposed Interim Rule. The proposed Interim Rule represents a minor modification to the Temporary Liquidity Guarantee Program (TLGP) to include certain issuances of mandatory convertible debt (MCD) under the TLGP debt guarantee program.

Discussion

In October 2008 the FDIC adopted the TLGP. This program is part of a coordinated effort by the FDIC, the U.S. Department of the Treasury, and the Board of Governors of the Federal Reserve System (Federal Reserve) to address unprecedented disruptions in credit markets and the resultant effects on the ability of financial institutions to fund themselves and to make loans to creditworthy borrowers. The TLGP and other programs have had favorable effects, but experience has indicated that further improvements to the TLGP can be made. In the proposed Interim Rule, staff is proposing a very narrow targeted improvement to the TLGP. The intent of the MCD amendment to the TLGP is to give eligible entities additional flexibility to obtain funding from investors with longer-term investment horizons and to reduce the concentration of FDIC guaranteed debt maturing in mid-2012, which debt might otherwise have to be rolled into new debt.[1]

II. The Interim Rule

Amendment to allow FDIC guarantees of mandatory convertible debt

As currently written, the TLGP regulation, at Section 370.2(e)(5), precludes an FDIC guarantee for any "convertible debt." Staff proposes amending the regulation to allow eligible entities to apply to have the FDIC guarantee newly issued senior unsecured debt with a feature that mandates conversion of the debt into common shares of the issuing entity at a specified date no later than the expiration date of the FDIC's guarantee. No FDIC-guaranteed MCD may be issued without the FDIC's prior written approval.

To be eligible for the FDIC's guarantee, MCD must be newly issued on or after February 27, 2009 and 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.) In addition, the proposed Interim Rule provides for a number of disclosures relative to MCD.

[1] This extension of the TLGP is supported by the rationale for establishing the existing TLGP and is consistent with the determination of systemic risk made on October 14, 2008, pursuant to 12 U.S.C. section 1823(c)(4)(G), by the Secretary of the Treasury (after consultation with the President) following receipt of the written recommendation dated October 13, 2008, of the FDIC's Board of Directors (Board) and the similar written recommendation of the Federal Reserve.

This amendment will not result in a change to an eligible entity's existing debt guarantee cap.

The Interim Rule requires a participating entity to file a written application with the FDIC and its appropriate Federal banking agency, and to obtain the FDIC's prior written approval, before issuing MCD.

Like other applications described in the TLGP, an eligible entity that wishes to issue MCD must include the details of the request, a summary of the applicant's strategic operating plan, and a description of the proposed use of the debt proceeds. In addition, an application to issue FDIC-guaranteed MCD must include the proposed date of issuance, the amount of MCD to be issued, the mandatory conversion date, and the conversion rate (as described in Section 370.3(h)). Finally, since the issuance of debt that will convert into stock could raise control issues, an applicant seeking to issue FDIC-guaranteed MCD must provide confirmation that the applicant has submitted to its appropriate Federal banking agency all applications and all notices required under the Bank Holding Company Act of 1956, the Home Owners' Loan Act, or the Change in Bank Control Act in order to issue the debt.

The amount of the assessment fee for the FDIC's guarantee of MCD will be based on the time period from issuance of the MCD until its mandatory conversion date.

Effective Date and Comment Period

Staff recommends that the Board find good cause for making this modification effective immediately as an interim regulation.

Staff further recommends that the Board seek comment on the interim regulation during a 15 day comment period.