October 23, 2008

MEMORANDUM: The Board of Directors

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SUBJECT: Temporary Liquidity Guarantee Program

Recommendation

Staff recommends that the Board of Directors ("Board") authorize publication of the attached Interim Rule and Request for Comment with respect to the Federal Deposit Insurance Corporation's ("FDIC's") temporary liquidity guarantee program in the *Federal Register* with a comment period of fifteen days.

In addition, staff recommends that the Board delegate to the Divisions and Officers authority to implement the Temporary Liquidity Guarantee Program ("TLG Program") within their areas of responsibility. It is anticipated that much of that authority will then be redelegated.

Background

On October 13, 2008, the Board of the FDIC made a systemic risk recommendation, with the written concurrence of the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury, after consultation with the President, determined that the systemic risk exception should be invoked in compliance with section 141 of the Federal Deposit Corporation Improvement Act of 1991, 12 U.S.C §1823(c)(4). In order to mitigate or avoid adverse effects on financial stability, the FDIC announced the TLG Program under which the FDIC would guarantee, subject to certain limitations, all senior unsecured debt of insured depository institutions and certain holding companies issued between October 14, 2008 and June 30, 2009, with guarantees expiring not later than

June 30, 2012. The FDIC also announced a transaction account guarantee program that provides a one hundred percent guarantee of noninterest-bearing transaction accounts held by FDIC-insured depository institutions, until December 31, 2009. The proposed Interim Rule will provide the public with necessary details of the conditions and requirements of the programs and provide a brief opportunity for comment.

Executive Summary

Subject to the conditions set forth in the regulation, the TLG Program consists of two basic components: a temporary guarantee of newly-issued senior unsecured debt ("debt guarantee program") and a temporary full guarantee of funds in certain noninterest-bearing transaction accounts at FDIC-insured depository institutions ("transaction account guarantee program").

The protections provided by these programs will be extended to any eligible entity as defined in § 370.2 of the proposed regulation. Eligible entities will include any FDIC-insured depository institution, any United States bank holding company including financial holding companies, and any United States 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 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 TLG Program unless it has a chartered, and operating, insured depository institution.

The rule explains that the FDIC has primary authority over the TLG Program. The FDIC will make every effort to work with the appropriate Federal regulator. However, any final decision regarding the parameters, eligibility and continued participation in the TLG Program remains with the FDIC. By issuing debt that is guaranteed under the TLG Program, the eligible entity consents to be bound by the parameters of the TLG Program. This consent acknowledges the FDIC's authority over the program and agreement to provide relevant information and to permit on-site reviews as needed after consultation with the appropriate federal banking agency to determine compliance with the terms and requirements of the TLG Program.

Initially, all eligible entities are covered under the TLG Program without cost to the entity for the first 30 days of the program, unless the entity opts out within the initial 30 day period. On or before November 12, 2008, eligible entities must inform the FDIC whether they will opt-out of the TLG Program. 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. An eligible entity's decision to opt out of either component of the TLG Program will be made publicly available. The FDIC will maintain and will post on its website a list of those

entities that have opted out of either or both components of the TLG Program so that possible lenders and transaction account depositors can tell when an entity has taken itself outside the program.

A. The Debt Guarantee Program

The Interim Rule establishes that the FDIC controls both participation in and the amount of debt that can be guaranteed under the debt guarantee program. The Interim Rule explains that 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. For firms that opt out, the guarantee of their debt will end no later than 11:59 pm EST November 12, 2008. Senior unsecured debt means unsecured borrowing that: (a) is evidenced by written agreement; (b) has a specified and fixed principal amount to be paid in full on demand or on a date certain; (c) is noncontingent; and (d) is not, by its terms, subordinated to any other liability. Senior unsecured debt includes, without limitation, 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. 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. Senior unsecured debt may be denominated in foreign currency. Senior unsecured debt does not include, e.g., 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, and deposits in foreign currency and Eurodollar deposits that represent funds swept from individual, partnership or corporate accounts held at insured depository institutions.

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 up to three years beyond this date, until June 30, 2012. 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. If an eligible entity chooses to opt out of the debt guarantee program, the FDIC's debt guarantee will terminate the earlier of 11:59 pm EST on November 12, 2008 or at the time of the eligible entity's opt out decision.

The FDIC will guarantee under this program 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. This 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 the FDIC, it may also restrict the authority of an entity to issue guaranteed debt to a level below the 125 percent limitation. 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.

Debt can 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.

B. 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. A "noninterest-bearing transaction account" is defined as a transaction account on which the insured depository institution pays no interest and does not reserve the right to require advance notice of intended withdrawals. This definition encompasses traditional checking accounts that allow for an unlimited number of deposits and withdrawals at any time. This definition, however, does not encompass 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, that account does not qualify for a guarantee under the transaction account guarantee program. In addition, funds swept into nontransaction accounts such as savings accounts are not covered. The Interim Rule makes an exception to this treatment of sweep accounts where funds are swept from a noninterest-bearing transaction account to a noninterest-bearing savings account. In that case, the swept funds will be guaranteed under the transaction account guarantee program. Otherwise, funds swept into an interest-bearing account will be insured under the FDIC's general deposit insurance regulations at 12 CFR Part 330.

The Interim Rule makes clear that the guarantee provided for noninterest-bearing transaction accounts is in addition to and separate from the coverage provided under the FDIC's general deposit insurance regulations at 12 CFR Part 330.

C. Fees for the TLG Program

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 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 prohibited from issuing non-guaranteed debt until the maximum allowable amount of guaranteed debt has been issued. A participating entity can then issue non-guaranteed debt in any amount and for any maturity. If a participating entity nonetheless issues 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.

Participating entities can take part in the guaranteed debt program as outlined above without any further action on their part. 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. The fee would be applied to 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 fee would equal 75 basis point charged for six months. The six month period is based upon estimates of the weighted average remaining maturity of existing debt that matures before June 30, 2009. It recognizes that much of the outstanding debt as of September 30, 2008, which is not guaranteed, will be rolled over into guaranteed debt only when the outstanding debt matures. The nonrefundable fee will be collected in six equal monthly installments. An entity electing the nonrefundable fee option will also be billed as it issues guaranteed debt under the debt guarantee program, and the amounts paid as a nonrefundable fee will be applied to offset these bills until the nonrefundable fee is exhausted. Thereafter, the institution will have to pay additional assessments on guaranteed debt as it issues the debt.

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 under Part 327 of the FDIC's rules and regulations. Assessments associated with the transaction account guarantee program will be in addition to an institution's risk-based assessment imposed under Part 327 of the FDIC's rules and regulations.

The Interim Rule requires the FDIC to impose an emergency special assessment on insured depository institutions if the fees and assessments collected under the TLG Program are insufficient to cover any loss incurred as a result of the TLG Program. In addition, if at the conclusion of these programs there are any excess funds collected from the fees associated with the TLG Program, the funds will remain as part of the Deposit Insurance Fund.

D. Payment of Claims by the FDIC pursuant to the TLG Program

In line with its long-established practice of paying depositors as soon as possible after an institution's failure, the FDIC will make every effort to handle guarantee claims expeditiously. The FDIC will be subrogated to the rights of any creditor it pays under the program.

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 to the date of the filing of a bankruptcy petition respecting 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 is specifically requesting suggestions on ways in which the claims process might be modified to speed payment without putting the FDIC at undue risk.

The Interim Rule sets forth the process for payment and recovery under the transaction account guarantee program. Under the 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 will follow the procedures prescribed for deposit insurance claims pursuant to section 11(f) of the FDI Act, 12 U.S.C. § 1821(f), and the FDIC will be subrogated to the rights of depositors against the institution pursuant to section 11(g) of the FDI Act, 12 U.S.C. § 1821(g).