April 12, 2010

MEMORANDUM TO: The Board of Directors

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SUBJECT: Interim Rule with request for comment: Amendment of the Temporary Liquidity Guarantee Program to Extend the Transaction Account Guarantee Program with Opportunity to Opt Out

I. SUMMARY OF RECOMMENDATION

Staff recommends that the Board adopt and authorize publication in the *Federal Register* of the attached proposed Interim Rule. The proposed Interim Rule would amend the Transaction Account Guarantee (TAG) Program, a component of the Temporary Liquidity Guarantee Program (TLGP), to: (1) extend the expiration date for the TAG program for six months, from July 1, 2010, through December 31, 2010, with the possibility of an additional 12-month extension, through December 31, 2011, without further rulemaking, upon a determination by the Board that continuing economic difficulties warrant such an extension, with no increase in assessments for participating insured depository institutions (IDIs); (2) require TAG assessment reporting based on average daily account balances; (3) reduce the maximum interest rate for qualifying negotiable order of withdrawal (NOW) accounts guaranteed by the FDIC pursuant to the

TAG program from a rate no higher than 0.50 percent to a rate no higher than 0.25 percent; (4) provide an irrevocable, one-time opportunity for IDIs currently participating in the TAG program to opt out of the program, effective on July 1, 2010; and (5) establish conforming disclosure requirements for IDIs that opt out of and those that continue to participate in the extended TAG program.

II. BACKGROUND

In October 2008, the Board adopted the TLGP following a determination of systemic risk by the Secretary of the Treasury (after consultation with the President) that was supported by recommendations from the FDIC and the Board of Governors of the Federal Reserve System (Federal Reserve). The TLGP is part of an ongoing and coordinated effort by the FDIC, the U.S. Department of the Treasury, and the Federal Reserve to address unprecedented disruptions in the financial markets and preserve confidence in the American economy.

The FDIC's October 2008 interim rule provided the blueprint for the TLGP. The TLGP comprises two distinct components: the Debt Guarantee Program (DGP), pursuant to which the FDIC guarantees certain senior unsecured debt issued by entities participating in the TLGP, and the TAG program, pursuant to which the FDIC guarantees all funds held at participating IDIs (beyond the maximum deposit insurance limit) in qualifying noninterest-bearing transaction accounts. A final rule adopted by the Board on November 21, 2008, included certain qualifying NOW accounts, among other accounts, as a type of noninterest-bearing transaction account guaranteed by the FDIC pursuant to the TAG program.

The TAG program originally was set to expire on December 31, 2009. The Board recognized that the TAG program was contributing significantly to improvements in the financial sector, and also noted that many parts of the country were still suffering from the effects of economic turmoil. As a result, on August 26, 2009, following a public notice and comment period, the Board extended the TAG program through June 30, 2010, with certain modifications to the program. For example, beginning on January 1, 2010, assessments increased and were to be based on an IDI's risk profile; rates now range from 15 basis points to 25 basis points. Further, the Board provided for an opt out for participating IDIs and established conforming disclosure requirements.

The TAG program continues to provide essential support to the banking industry, particularly as community banks remain distressed. Nearly 6,400 IDIs, representing approximately 80 percent of the industry, continue to participate in the TAG program and benefit from the guarantee provided by the FDIC. These institutions held an estimated $340 billion of deposits in accounts currently subject to the FDIC's guarantee as of the end of 2009. Of these, $266 billion represented amounts above the insured deposit limit and guaranteed by the FDIC through its TAG program. Among the current participating IDIs, the average TAG account size was about $1.15 million. About 550 IDIs relied on TAG accounts to fund 10 percent or more of their assets. In the challenging banking environment that we are experiencing, smaller IDIs continue to find the TAG program especially beneficial. They report that the TAG program enables them to retain longstanding transaction account relationships, such as payroll accounts from municipalities and small businesses, thereby enhancing confidence in their particular financial institution, as well as in the banking system as a whole.

Staff recommends that the FDIC adopt the proposed Interim Rule extending the TAG program for six months through December 31, 2010, with the possibility of an additional 12-month extension, through December 31, 2011, without further rulemaking upon a determination by the Board that continuing economic difficulties warrant such an extension. If the Board determines that an additional 12-month extension of the TAG program is warranted, the proposed preamble to the Interim Rule provides that an announcement to that effect will be made by the FDIC no later than October 29, 2010. Staff believes this action will provide additional stability for participating IDIs and enhance the likelihood of a continuing and sustainable economic recovery in the financial sector. Staff further believes that by stabilizing noninterest-bearing transaction accounts, the proposed extension also could mitigate further losses to the Deposit Insurance Fund (DIF) by decreasing the resolution costs related to future bank failures.

Staff is concerned that allowing the TAG program to expire in the current environment could cause a number of community banks to experience deposit withdrawals from their large transaction accounts and risk needless liquidity failures. Moreover, to the extent that banks replace these deposits with brokered deposits or secured borrowings, their overall liquidity risk profile would increase going forward. Finally, the loss of longstanding large deposit relationships would negatively affect banks' franchise values to an acquirer in the event of a subsequent failure, increasing the FDIC's resolution costs.

III. THE PROPOSED INTERIM RULE

Under the proposed Interim Rule, which provides for a 30-day public comment period, the FDIC would extend the duration of the TAG program through December 31, 2010, with no increase in assessments associated with participation in the program. The Interim Rule also provides for the possibility of an additional 12-month extension of the TAG, through December 31, 2011, without further rulemaking should the Board determine that such extension is warranted. Although the Interim Rule proposes no increase in fees for continued participation in the TAG program, it modifies the basis upon which a participating IDI's assessment is calculated to reflect a change from quarter-end reporting to average daily account balance reporting for TAG-related accounts. In addition, in order to align NOW accounts covered by the TAG program with current market rates and to ensure the program is not used inappropriately by institutions to attract interest-rate-sensitive deposits to fund risky activities, the proposed Interim Rule would reduce the interest rate on NOW accounts eligible for the FDIC's guarantee from a maximum of 0.50 percent to a maximum of 0.25 percent. Participating IDIs would be required to commit to maintain the interest rate on such accounts at or below 0.25 percent until the TAG program concludes on December 31, 2010, or December 31, 2011, if the Board authorizes an additional extension of the program.

If issued, the proposed Interim Rule would modify the existing regulatory requirements placed on IDIs participating in the TAG program. Some participating IDIs may feel that their existing financial condition or future business plans would be best served by discontinuing their involvement with the TAG program. For these reasons, the proposed Interim Rule provides an irrevocable, one-time opportunity for currently participating IDIs to opt out of the extended TAG program. The proposed Interim Rule provides that a decision by an IDI to remain in the TAG program will obligate the institution to continue its participation in the program through December 31, 2010, or for an additional 12 months, through December 31, 2011, if the Board further extends the TAG program. Finally, the proposed Interim Rule requires conforming disclosure requirements from IDIs that choose to opt out, as well as those that continue to participate in the extended TAG program.

IV. CONCLUSION

Staff recommends that the Board adopt the attached proposed Interim Rule and authorize its publication in the *Federal Register*.