SIMPSON THACHER

CLIENT MEMORANDUM

Federal Deposit Insurance Corporation Temporary Liquidity Guarantee Program

October 24, 2008

INTRODUCTION

On October 23, 2008, the Federal Deposit Insurance Corporation's Board of Directors issued an Interim Rule and Request for Comment implementing the Temporary Liquidity Guarantee Program ("TLGP"). The TLGP was originally announced on October 14, 2008, following a determination of systemic risk pursuant to Section 13(c)(4)(G) of the Federal Deposit Insurance Act. This determination came in response to serious disruptions to the credit markets and financial system. The goal of the TLGP is to restore inter-bank lending, encourage liquidity and strengthen confidence in the banking system. The TLGP has two primary components:

- The FDIC will guarantee new senior unsecured debt issued on or before June 30, 2009 by eligible banks, thrifts, and their holding companies (the "Debt Guarantee Program"). This coverage will extend no later than June 30, 2012, regardless of whether the debt's maturity exceeds that date.
- The FDIC will provide unlimited insurance coverage for noninterest-bearing deposit accounts (the "Transaction Account Guarantee Program"). This replaces the current maximum limit of $250,000. This temporary guarantee expires on December 31, 2009.

The Interim Rule became effective on October 23, 2008, and is designed to provide the public with necessary details of the conditions and requirements of the program and provide a brief opportunity for comment. The public comment period lasts 15 days from the publication of the Interim Rule in the Federal Register.

ELIGIBILITY AND OPT-OUT

Eligibility for the TLGP is defined in § 370.2 of the Interim Rule. It extends to (i) FDIC-insured depository institutions, (ii) U.S. bank holding companies, (iii) U.S. financial holding companies, and (iv) certain U.S. savings and loan holding companies. A savings and loan holding company is eligible if it engages only in activities that are permissible for financial holding companies to conduct under section 4(k) of the Bank Holding Company Act *or* it has at least one insured depository institution subsidiary that is subject to an application under Section 4(c)(8) of the Bank Holding Company Act as of October 13, 2008. The latter phrase appears to be designed to cover Merrill Lynch. Foreign banks are not eligible for the TLGP, except that U.S. branches of foreign banks that are insured by the FDIC are eligible for the Transaction Account Guarantee Program.

All eligible entities are automatically covered under the TLGP for 30 days from its inception and have until November 12, 2008 to opt out. For eligible entities deciding to opt out, the FDIC's guarantee under both the Debt Guarantee Program and the Transaction Account Guarantee program will expire at 11:59 pm EST on November 12, or at the time the FDIC receives the opt-out decision, whichever is earlier. If an eligible entity chooses not to opt out by November 12, it will automatically become a participant in the TLGP for its duration and cannot later opt out. This applies to both the Debt Guarantee Program and the Transaction Account Guarantee Program.

An eligible entity may opt out of one or both components of the TLGP. However, all eligible entities within a U.S. bank holding company or a U.S. savings and loan holding company must make the same decision regarding their participation in the TLGP. Therefore, it is not possible for certain entities to opt out of one of the components of the TLGP while others participate in that component.

The FDIC has also reserved the right to extend the Debt Guarantee Program to cover an otherwise ineligible affiliate of an eligible entity on a case-by-case basis following a written request and positive recommendation made by the appropriate federal banking agency. The FDIC has suggested that factors it will examine in making such a determination include the extent of the activity and strength of the obligation it is being asked to guarantee, as well as the size of the entity seeking coverage. Based on the conference calls that the FDIC has sponsored to discuss the TLGP, it appears that such applications are likely to be approved only in special situations, such as the case of a nonbank subsidiary of a bank holding company that issues debt that is guaranteed by a bank holding company, and that it is not likely that it will be used, for example, to guarantee debt of holding companies that are not regulated as bank or savings and loan holding companies.

DEBT GUARANTEE PROGRAM

Under the Debt Guarantee Program, senior unsecured debt issued between October 14, 2008, and June 30, 2009 will have a full guarantee from the FDIC. Qualifying debt would be fully protected in the event the issuing institution subsequently fails, or its holding company files for bankruptcy. This coverage extends three years beyond the termination date of the Debt Guarantee Program. Therefore, all debt issued within the coverage period will be guaranteed until June 30, 2012. If debt has a term that extends beyond June 30, 2012, only the payments due before that date will be covered. Thus, entities participating in the Debt Guarantee Program may elect to issue wholly non-guaranteed debt so long as no payments are due until after the cutoff date.

Each eligible entity is authorized to issue guaranteed debt up to 125% of the par or face value of its senior unsecured debt that was outstanding as of September 30, 2008 and scheduled to mature before June 30, 2009. This limit is individually calculated for each eligible entity within an organization, not on a consolidated holding company basis. Under procedures to be detailed shortly, 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. The practical impact of this limit is to allow eligible entities to roll over all of their preexisting senior unsecured debt as it becomes due over the course of the TLGP as well as add an additional 25%. The FDIC will consider applications to participate in the program from eligible entities that happened not to have any senior unsecured debt outstanding on September 30, 2008.

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 of an insured depository institution, and Eurodollar deposits standing to the credit of a bank. Senior unsecured debt does not include, among other things, 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. Also excluded are loans to affiliates, including parents and subsidiaries, and institution affiliated parties.

Eligible entities are not permitted to issue guaranteed debt in excess of the 125% cap, nor are they permitted to issue non-guaranteed debt until the maximum allowable amount of guaranteed debt has been issued. (Violation of these provisions will subject a participating entity to an increased assessment rate for the entirety of its debt, as well as enforcement actions.) Once the 125% cap has been reached, a participating entity can issue non-guaranteed debt in any amount and for any maturity. On a case-by-case basis, the FDIC may grant a participating entity authority to temporarily exceed the 125% 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% limitation.

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, calculated for the maturity period of that debt or June 30, 2012, whichever is earlier. Thus, participating entities will only be assessed for the debt that is covered under the Debt Guarantee Program.

Although participating entities are generally not permitted to issue non-guaranteed debt until they have issued the maximum amount of guaranteed debt, eligible entities are permitted to partially opt out of the Debt Guarantee Program in order to have the option of issuing certain non-guaranteed senior unsecured debt before issuing the maximum amount of guaranteed debt. This option, which must be elected on or before November 12, 2008, requires payment of an initial non-refundable fee. The fee will 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 will equal the 75 basis point annual rate charged for six months (or 37.5 basis points). Although this fee is nonrefundable, the amounts paid as a nonrefundable fee will be applied to offset the fees for guaranteed debt until the nonrefundable fee is exhausted. Thereafter, the institution will have to pay additional assessments on guaranteed debt as it issues the debt.

The six month period is based upon estimates of the weighted average remaining maturity of existing debt that matures before June 30, 2009. An entity selecting this option will then be able to issue debt with a maturity later than June 30, 2012 that is entirely non-guaranteed, as opposed to guaranteed through June 30, 2012 and non-guaranteed beyond.

TRANSACTION ACCOUNT GUARANTEE PROGRAM

The Transaction Account Guarantee Program provides a temporary full guarantee for noninterest-bearing transaction accounts. The intent was to cover transaction accounts maintained by business customers, such as payment-processing accounts. This focus reflects the desire of the FDIC to prevent otherwise viable regional banks from failing as the result of business customers withdrawing their money due to a perception that larger institutions are inherently safer. However, all noninterest-bearing transaction accounts are eligible. This guarantee is in addition to the FDIC's general deposit insurance.

Under the Interim Rule, a noninterest-bearing transaction account is defined as a transaction account where interest is neither accrued nor paid and for which the insured depository institution does not require advance notice of an intended withdrawal. This definition encompasses traditional checking accounts, as well as official checks issued by an insured depository institution. It, however, does not encompass negotiable order of withdrawal accounts or money market deposit accounts.

Many banks offer a product to business customers in which balances in noninterest-bearing transaction accounts are swept at the end of the day into non-interest bearing savings accounts. The purpose of this sweep is to reduce the amount of reserves that the bank is required to maintain against their deposits. Although such "savings accounts" are not transaction accounts, the FDIC decided to accommodate this practice by including funds swept into such non-interest bearing savings accounts as fully-insured.

Another product that raised questions is escrow accounts set up by lawyers that are required under state law to make an interest payment to state bar associations. Although the beneficiaries of such accounts do not receive such interest, the FDIC declined to treat such deposits as noninterest-bearing transaction accounts that are entitled to full insurance.

Participating entities will be assessed a fee against amounts exceeding $250,000 in noninterest-bearing accounts under the Transaction Account Guarantee Program. This fee will be an annualized 10 basis points assessed on a quarterly balance. As noted above, this temporary guarantee expires on December 31, 2009.

FEES

The TLGP requires no taxpayer funding and is intended to be fully covered by the fees assessed participating entities. There is no fee to participate for the initial 30 days. For the remainder of the program, participating entities will be assessed the two fees previously discussed for the Debt Guarantee Program and the Transaction Account Guarantee Program.

If, at the conclusion of the TLGP, the fees collected exceed the cost of any payouts, the excess will be placed in the Deposit Insurance Fund and will not be refunded. If there is a shortfall, the Interim Rule requires the FDIC to impose an emergency special assessment on insured depository institutions to cover any loss incurred as a result of the TLGP. This assessment would be authorized under the systemic risk provision in the Federal Deposit Insurance Act.

OVERSIGHT AND ENFORCEMENT

The FDIC has primary supervisory authority over the TLGP, but will work with primary regulators to ensure banks are complying with regulations. Entities who choose to participate in the Debt Guarantee Program and who issue guaranteed debt agree to supply information requested by the FDIC, as well as to be subject to periodic FDIC on-site reviews to determine compliance with the terms and requirements of the Debt Guarantee Program.

The FDIC will also maintain and post on its website a list of those entities that have opted out of either or both components of the TLGP so that potential lenders and depositors can tell when an entity has taken itself outside the program. Entities participating in the Debt Guarantee Program must also disclose in a commercially reasonable manner to counterparties whether the debt they are offering is guaranteed by the FDIC. Similarly, eligible entities must prominently disclose in writing at their main office and at all branches at which deposits are taken whether they are participating in or opting out of the Transaction Account Guarantee Program.

The FDIC staff had indicated that any lender that reasonably believed that senior unsecured debt of a banking organization was guaranteed under the Debt Guarantee Program would be protected even if the issuer had inadvertently or intentionally exceeded its guaranteed limit or was otherwise not in compliance with the TLGP. The Interim Rule does not include comfort on this point.

The Interim Rule sets forth the process for payment and recovery under both components of the TLGP. Under the Transaction Account Guarantee Program, the FDIC's obligation to make payment in its capacity as guarantor 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 will generally follow the established procedures for deposit insurance claims and contemplate that the claim will be paid on the business day after the bank is placed in receivership.

Under the Debt Guarantee Program, the FDIC anticipates that, in the event of the failure of a federally insured depository institution, payments will be made in most instances on the next business day after a claim is determined to be valid. In the event of a bankruptcy of a participating holding company entity, the FDIC will endeavor to make payment as quickly as possible, but generally will not make payment for the guaranteed amount for debt asserted against a bankruptcy estate, unless and until the claim for the unsecured senior debt has been determined to be an allowed claim against the bankruptcy estate and such claim is not subject to reconsideration under 11 U.S.C. §502(j). If the FDIC does not make payment within one business day of the filing of the bankruptcy petition, it will pay interest at the 90 day T-bill rate until payment is made.

OPEN QUESTIONS

As part of the public comment period, the Interim Rule and Request for Comment has specifically requested guidance on the following issues:

- Ways in which the claims process for the Debt Guarantee Program may be modified to speed payment to eligible claimants without putting at risk the funds administered by the FDIC. This is particularly relevant in the context of a bankruptcy filing by a holding company.
- Whether the definition of noninterest-bearing transaction account should be modified to include coverage for negotiable order of withdrawal accounts held by sole proprietorships, non-profit religious, philanthropic, charitable organizations and the like, or governmental units for the deposit of public funds if the interest paid is de minimis.
- Whether the certainty of payment provided by the required disclosures relative to the FDIC's Debt Guarantee Program to lenders and creditors outweighs the burden on participating entities in providing the disclosures.

CONCLUSION

Given the speed with which the TLGP and the Interim Rule were created, a number of technical issues remain unresolved. In addition, further guidance will undoubtedly be required as new contingencies arise. However, the Interim Rule provides an important backstop to encourage inter-bank lending, restore liquidity and protect the viability of smaller banks that would otherwise be vulnerable to massive withdrawals by business customers concerned about the safety of large deposits.

For more information, please contact one of the following, or another member of the Firm's Financial Institutions Group.

Lee Meyerson
212-455-3675
lmeyerson@stblaw.com
Gary Rice
212-455-7345
grice@stblaw.com
John L. Walker
212-455-7365
jwalker@stblaw.com

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
212-455-2000

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
650-251-5000

Washington, D.C.
601 Pennsylvania Avenue, N.W.
North Building
Washington, D.C. 20004
202-220-7700

EUROPE

London
Citypoint
One Ropemaker St.
London EC2Y 9HU England
+44-20-7275-6500

ASIA

Beijing
3119 China World Tower One
1 Jianguomenwai Avenue
Beijing 100004, China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road
Hong Kong
+852-2514-7600

Tokyo
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037, Japan
+81-3-5562-6200