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CLIENT MEMORANDUM

Federal Deposit Insurance Corporation Adopts Temporary Liquidity Guarantee Program Final Rule

November 25, 2008

INTRODUCTION

On November 21, 2008, the Federal Deposit Insurance Corporation's Board of Directors adopted a Final Rule relating to 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 transaction accounts (the "Transaction Account Guarantee Program"). This replaces the current maximum limit of $250,000. This temporary guarantee expires on December 31, 2009.

On October 23, 2008, the FDIC issued an Interim Rule with request for comments and, on November 4, 2008, amended the Interim Rule to extend several deadlines under the TLGP. The Final Rule contains several substantive changes from the Amended Interim Rule.

CHANGES FROM THE AMENDED INTERIM RULE

The Final Rule contains the following substantive changes from the Amended Interim Rule:

- The definition of senior unsecured debt was revised to exclude any obligation with a stated maturity of 30 days or less.

- The process for the repayment of claims under the Debt Guarantee Program was altered to (1) trigger the FDIC's payment obligation in the event of a payment default (rather than upon the initiation of insolvency proceedings); (2) provide that the FDIC will continue to make interest and principal payments under the terms of the debt instrument in the event of a payment default; and (3) require participating institutions to acknowledge they will be unconditionally liable for any amounts paid by the FDIC as guarantor and to sign a Master Agreement as a part of their notification of participation.
- A participating entity that is an insured depository institution and that had no senior unsecured debt as of September 30, 2008 may issue debt under the Debt Guarantee Program in an amount up to two percent of its consolidated total liabilities as of September 30, 2008.
- A participating insured depository institution may issue debt under the Debt Guarantee Program up to its own debt guarantee limit as well as its holding company's debt guarantee limit as long as the total debt issued does not exceed the combined limit for the two entities. However, a participating holding company may not utilize the debt guarantee limit of its subsidiary insured depository institutions.
- The definition of noninterest-bearing transaction accounts was revised to include Interest on Lawyers Trust Accounts ("IOLTAs") and low-interest negotiable order of withdrawal accounts ("NOW accounts").
- Specific language was prescribed for the disclosure requirements under the Debt Guarantee Program and specific language was suggested for the disclosure requirements under the Transaction Account Guarantee Program.
- The assessment structure for the Debt Guarantee Program was revised to provide for different assessments depending on the maturity of the debt.

These changes are discussed in greater detail in the sections that follow.

ELIGIBILITY AND OPT-OUT

Eligibility for the TLGP is defined in § 370.2(a) of the Final Rule. It extends to (i) FDIC-insured depository institutions, (ii) U.S. bank holding companies, and (iii) 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 the period from October 14, 2008 through December 5, 2008. Eligible entities may opt out on or before December 5, 2008. 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 the time the FDIC receives the opt-out decision. If an eligible entity chooses not to opt out by December 5, 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 same decision regarding their participation in the TLGP. Therefore, it is not possible for one entity within a holding company to opt out of one of the components of the TLGP while another participates 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 financial activity of the entities within the holding company structure, the strength from a rating perspective of the issuer of the obligations that will be guaranteed, and the size and extent of the activities of the organization. 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, qualifying 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 of an uncured failure of a participating entity to make a timely payment of principal or interest as required under an FDIC-guaranteed debt instrument. All qualifying debt issued within the coverage period will be guaranteed until June 30, 2012.

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. However, with proper written notice both to the FDIC and its parent holding company, a participating insured depository institution may issue guaranteed debt in an amount equal to the institution's limit plus its holding company's limit, so long as the total guaranteed debt issued by the insured depository institution and its holding company do not exceed their combined debt guarantee limit. However, a participating holding company may not utilize the debt guarantee limit of its subsidiary insured depository institutions. The authorized amount may be issued immediately. Although the proceeds of guaranteed debt may not be used to prepay non-guaranteed debt, it is not necessary to wait for existing debt that is the basis for the limit to mature before issuing guaranteed debt up to the limit.

Each participating entity must 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 no later than December 5, 2008. If a participating entity that is an insured depository institution had either no senior unsecured debt as of September 30, 2008, or only federal funds purchased, its debt guarantee limit is two percent of its consolidated total liabilities as of September 30, 2008. The FDIC will consider applications to participate in the program from eligible entities other than insured depository institutions that happened not to have any senior unsecured debt outstanding on September 30, 2008.

Senior unsecured debt is defined as unsecured borrowing that (i) is evidenced by a written agreement or trade confirmation; (ii) has a specified and fixed principal amount; (iii) is noncontingent and contains no embedded options, forwards, swaps, or other derivatives; and (iv) is not, by its terms, subordinated to any other liability. In addition, after December 5, 2008, debt that has a maturity of less than 30 days is neither guaranteed nor subject to assessment under the Debt Guarantee Program. (However, such debt is included for purposes of calculating the guaranteed debt limit, which is based on the amount of debt outstanding on September 30, 2008.) The exclusion of short-term debt from coverage under the Debt Guarantee Program was requested by many banks that believed that the guarantee was not necessary and was unduly expensive for such debt. Senior unsecured debt may pay either a fixed or floating interest rate based on a single index of a Treasury bill rate, the prime rate, and LIBOR with a fixed amount of scheduled principal payments.

Senior unsecured debt includes, without limitation, federal funds; promissory notes; commercial paper; unsubordinated unsecured notes, including zero-coupon

bonds; U.S. dollar denominated certificates of deposit owed to an insured depository institution, an insured credit union as defined in the Federal Credit Union Act, or a foreign bank; U.S. dollar denominated deposits in an IBF of an insured depository institution owed to an insured depository institution or a foreign bank; and U.S. dollar denominated deposits on the books and records of foreign branches of U.S. insured depository institutions that are owed to an insured depository institution or a foreign bank.

Senior unsecured debt does not include, among other things, obligations from guarantees or other contingent liabilities; derivatives; derivative-linked products; debts that are paired or bundled with other securities; convertible debt; capital notes; the unsecured portion of otherwise secured debt; negotiable certificates of deposit; deposits denominated in a foreign currency or other foreign deposits (except those otherwise permitted in the rule); revolving credit agreements; structured notes; instruments that are used for trade credit; retail debt securities; and any funds regardless of form that are swept from individual, partnership, or corporate accounts held at depository institutions. Also excluded are loans to affiliates, including parents and subsidiaries, and institution affiliated parties. "Retail debt securities" means those that are *exclusively* marketed to retail customers (typically in small denominations).

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. The FAQ that was issued by the FDIC staff at the same time as the Final Rule states that if an issuer is not listed on the FDIC web site as having opted out of the Debt Guarantee Program, and the lender receives disclosure from the issuer stating that the debt in question is guaranteed under the Debt Guarantee Program, then the lender will receive the benefit of the guarantee even if the issuer had inadvertently or intentionally exceeded its guaranteed limit or was otherwise not in compliance with the TLGP.

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.

Beginning November 13, 2008, assessments will be charged on all eligible debt issued on or after October 14, 2008 that is still outstanding on December 5, 2008 through June 30, 2009. For debt with a maturity of 31-180 days, 181-364 days and 365 days or greater, the annualized assessment rate is 50 basis points, 75 basis points and 100 basis points, respectively. This rate will be increased by 10 basis points for senior unsecured debt issued by a holding company or another non-insured depository institution affiliate that becomes an eligible and participating entity, where, as of September 30, 2008, or as of the date of eligibility, the assets of the holding company's combined insured depository institution subsidiaries constitute less than 50 percent of consolidated holding company assets.

Although participating entities are generally not permitted to issue non-guaranteed debt until they have issued the maximum amount of guaranteed debt, eligible entities may, for a fee, elect to have the option of issuing non-guaranteed senior unsecured debt with maturities beyond June 30, 2012 before issuing the maximum amount of guaranteed debt. This option, which must be elected on or before December 5, 2008, requires payment of an initial non-refundable fee equal to 37.5 basis points times the par or face value of senior unsecured debt outstanding as of September 30, 2008 that is scheduled to mature by June 30, 2009. 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 such debt.

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 Final Rule, a noninterest-bearing transaction account is defined as a transaction account as defined in 12 CFR 204.2 that is (i) maintained at an insured depository institution; (ii) with respect to which interest is neither accrued nor paid; and (iii) on which the insured depository institution does not reserve the right to 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 does not, for example, encompass money market deposit accounts or NOW accounts (but there is an exception for low-interest NOW accounts, as discussed below).

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.

In response to comments, the FDIC also provided exceptions to the definition of noninterest-bearing transaction account so as to include IOLTAs and low-interest NOW accounts. As a result, assuming that the other requirements of the Transaction Account Guarantee Program are met by a participating entity and irrespective of the standard maximum deposit insurance amount defined in 12 CFR Part 330, IOLTAs will be guaranteed by the FDIC in full as noninterest-bearing transaction accounts. NOW accounts with interest rates no higher than 0.50% also will be treated as noninterest-bearing transaction accounts. The interest rate must not exceed 0.50% at any time prior to the expiration date of the program. If an insured depository institution that currently offers NOW accounts at interest rates above 0.50% readjusts the interest rate on such accounts to a rate no higher than 0.50% before January 1, 2009, and commits to maintain the adjusted rate until December 31, 2009, the affected NOW accounts will be considered noninterest-bearing transaction accounts for purposes of the Final Rule.

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

ASSESSMENTS

The TLGP requires no taxpayer funding and is intended to be fully covered by the assessments on participating entities. There is no assessment to participate for the initial period that ends on December 5, 2008. For the remainder of the program, participating entities will pay the two assessments previously discussed for the Debt Guarantee Program and the Transaction Account Guarantee Program.

If, at the conclusion of the TLGP, the assessments 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 Final 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 other bank 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 include the following disclosure statements in all written materials provided to lenders or creditors regarding any senior unsecured debt issued after December 19, 2008:

- For debt that is guaranteed under the Debt Guarantee Program:

  This debt is guaranteed under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program and is backed by the full faith and credit of the United States. The details of the FDIC guarantee are provided in the FDIC's regulations, 12 CFR Part 370, and at the FDIC's website, www.fdic.gov/tlgp. The expiration date of the FDIC's guarantee is the earlier of the maturity date of the debt or June 30, 2012.
- For debt that is not guaranteed under the Debt Guarantee Program:

  This debt is not guaranteed under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program.

Similarly, eligible entities must post a prominent notice at their main office, each domestic branch and, if they offer Internet deposit services, on their website whether they are participating in or opting out of the Transaction Account Guarantee Program. The Final Rule provides sample disclosures for both participating and non-participating institutions.

PAYMENT ON THE GUARANTEE

The Final Rule sets forth the process for payment and recovery under both components of the TLGP. This process is the same as provided for under the Interim Rule with respect to the Transaction Account Guarantee Program, but significantly altered with respect to the Debt Guarantee Program. 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.

The FDIC's payment obligation under the Debt Guarantee Program for eligible senior unsecured debt will be triggered by a payment default. The FDIC will continue to make scheduled interest and principal payments under the terms of the debt instrument through its maturity. The FDIC will not be bound by acceleration or penalty interest provisions. Although the Final Rule is less than perfectly clear on the point, it appears to provide that in the case of a payment default prior to June 30, 2012 on guaranteed debt that is scheduled to mature after June 30, 2012, the FDIC will be obligated to make all payments of principal and interest, including those scheduled after June 30, 2012. In such a case, rather than continuing to make principal and interest payments after June 30, 2012, the FDIC may, in its discretion, at any time after June 30, 2012, elect to make a final payment of all outstanding principal and interest due.

The FDIC will become subrogated to the rights of any debtholder against the issuer, including in respect of any insolvency proceeding, to the extent of the payments made under the guarantee. The Final Rule indicates that the FDIC generally will consider the failure of an insured depository institution to make a payment on its outstanding debt such that the FDIC is required to make payment under the guarantee as grounds for the appointment of the FDIC as conservator or receiver of such insured depository institution.

The Final Rule provides for a new claims filing process under which a claim may be filed with the FDIC by an authorized representative, as established by the issuer, of all the debtholders under a particular issuance. The Final Rule requires the participating entities to file with the FDIC a form which allows the issuer to establish a designated representative as part of its participation in the TLGP.

The FDIC will require specific information to be filed with any claim under the program. Such specific information must include evidence that a payment default has occurred under the terms of the debt instrument and that the claimant is the actual owner of the FDIC-guaranteed debt obligation or is authorized to act on behalf of the owner. In addition, the FDIC must receive an assignment of the debtholders' rights in the debt, as well as any claims in any insolvency proceeding arising in connection with ownership of FDIC-guaranteed debt.

The Final Rule also provides that any participating entity acknowledges by its participation in this program that it will become indebted to the FDIC for any payments the FDIC may make in satisfaction of its guarantee obligation or the satisfaction of the guarantee obligations of any affiliate. The issuer of guaranteed debt will be unconditionally liable to the FDIC for repayment of amounts expended under the guarantee. Further, in the event that a participating entity is placed into receivership or bankruptcy after the FDIC has made payment on its guarantee, the FDIC will be a bona fide creditor in those proceedings. Finally, the Final Rule requires participating entities to execute and file with the FDIC as part of its notification of participation in the Debt Guarantee Program a Master Agreement, which explicitly acknowledges a number of the arrangements discussed above.

CONCLUSION

The TLGP 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. Moreover, the Final Rule includes a number of positive responses to comments and addresses a number of outstanding issues. In particular, the revised procedure for the payment of claims under the Debt Guarantee Program should provide counterparties greater confidence in the soundness of the FDIC's guarantee.

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