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THE FDIC TEMPORARY LIQUIDITY GUARANTEE PROGRAM: FDIC FINAL RULE MAKES PROGRAM MORE USEFUL BUT REQUIRES QUICK DECISIONS

The FDIC announced its Temporary Liquidity Guarantee Program (the "TLG") on October 14, 2008. The TLG consists of (i) a temporary guarantee of noninterest-bearing transaction accounts maintained at eligible FDIC-insured depository institutions (the "Transaction Account Guarantee Program") and (ii) a temporary guarantee of newly issued unsecured senior eligible debt issued by eligible entities (the "Debt Guarantee Program"). The FDIC published an interim final rule (the "Interim Rule") on October 23 as Part 370 to the FDIC's regulations (*see* our comments on the Interim Rule under "Publications" at www.jonesday.com). The Interim Rule was subject to a 15-day comment period ending on November 13, 2008. The FDIC amended its Interim Rule effective November 4, 73 F.R. 66160-66163 (Nov. 7, 2008), and released its final rule on November 21, 2008 (the "Final Rule") regarding the TLG. The Final Rule significantly changes the Interim Rule.

Eligible entities must determine whether they will participate in either or both of the TLG programs on or before December 5, 2008, so these changes must be considered immediately. Fortunately, the Final Rule makes substantial improvements to the Interim Rule. Under the Interim Rule, we believe participation in the Transaction Account Guarantee Program was likely to be widespread, if not universal. The Final Rule does not appear to alter the expected level of participation in the Transaction Account Guarantee Program. The Final Rule, however, makes the Debt Guarantee Program more useful and cost-effective for a wider variety of institutions. The FDIC believes the Final Rule "will ensure that the majority of strong institutions will participate" in the Debt Guarantee Program. It appears that there are now few reasons to opt out of the Debt Guarantee Program.

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COVERAGE OF DEBT

The Final Rule revises the definition of "senior unsecured debt" to exclude unsecured debt issued after December 5, 2008, with a maturity of 30 days or less, including debts due on demand, from coverage under the Debt Guarantee Program. Many institutions were concerned that the assessments imposed under the Debt Guarantee Program were too high relative to their overnight borrowing costs and that they had been able to borrow federal funds without a FDIC guarantee. Any senior unsecured debt with a maturity of 30 days or less issued by eligible entities ("Short-Term Debt") issued from October 13, 2008, to December 5, 2008, will continue to be covered until maturity under the terms of the Interim Rule. The Final Rule makes clear that a trade confirmation will be a sufficient form of written agreement to establish eligibility under the Debt Guarantee Program.

Senior unsecured debt must (i) have a specified and fixed principal amount, (ii) be noncontingent and have no embedded options, forwards, swaps, or other derivatives, (iii) have a stated maturity of more than 30 days, and (iv) pay a fixed rate of interest or a floating rate of interest based on a commonly used reference rate with a fixed amount of scheduled principal payments. Except for deposits, senior unsecured debt may be denominated in U.S. dollars or foreign currencies, provided payments are in the same currency. Section 370.2(e) provides examples of debt that is covered and is not covered by the Debt Guarantee Program. Revolving credit agreements, retail debt securities, capital notes, convertible securities, debt that is paired or bundled with other securities, structured notes, and "one month" notes are among the instruments excluded from coverage. Debt used to prepay debt that is not FDIC-guaranteed is not covered by the Debt Guarantee Program.

Even though the FDIC's guarantee is now clearly a full faith and credit obligation of the United States, the release issuing the Final Rule states that guaranteed debt held by institutions subject to the bank regulators' risk-based capital rules will be subject to a 20 percent risk weighting. The release states that "FDIC-guaranteed debt is not intended to lower capital standards or free capital in the banking system." The effects of the debt guarantee on eligible investments and the regulatory capital effects on other regulated entities should be evaluated on a case-by-case basis.

U.S. dollar denominated interbank deposits with a maturity beyond 30 days, including nonnegotiable certificates of deposit, deposits in an IBF of an insured depository institution, and deposits on the books and records of a non-U.S. branch of a U.S. depository institution will be covered under the Debt Guarantee Program. Deposits denominated in a foreign currency and deposits at non-U.S. branches of U.S. depository institutions, however, will not be covered.

THE DEBT GUARANTEE PROGRAM CAP

The Debt Guarantee Program's guarantee of newly issued senior unsecured debt is limited at any time to 125 percent of the aggregate par value of each eligible entity's senior unsecured debt outstanding at the close of business on September 30, 2008, and which is scheduled to mature on or before June 30, 2009 (the "Cap"). For entities with no outstanding senior unsecured debt as of September 30, the Interim Rule permitted such entities to apply to the FDIC for permission to issue debt under the Debt Guarantee Program, but did not guarantee approval or provide for automatic coverage. The Final Rule provides several exceptions to the Cap:

- Although Short-Term Debt is excluded from coverage under the Debt Guarantee Program, such debt outstanding at September 30, 2008 is counted in determining the Cap.

- Insured depository institutions that have no senior unsecured debt outstanding as of September 30, 2008, will have an alternative cap equal to 2 percent of their consolidated total liabilities as of September 30, 2008 (the "Alternative Cap").

- Insured depository institutions may combine their Cap with the Cap of their parent holding companies and, upon notice to the FDIC, issue debt in an amount equal to the combined Cap as long as the total guaranteed debt does not exceed the combined Cap of the bank and its holding company.

The Cap for merged eligible entities is the sum of each merging entity calculated on a pro forma basis as of September 30, 2008, absent other action by the FDIC.

These exceptions expand coverage to entities that would otherwise be excluded from participation due to the existence of the Cap. The Alternative Cap does not apply to any eligible entities other than insured depository institutions, including parent holding companies. Thus, any other institution will continue to be restricted by the Cap, unless it obtains FDIC approval for coverage under the Debt Guarantee Program. Further, the ability to combine Caps is limited to participating entities within a holding company structure and may not be extended to affiliates.

The FDIC reserves the right to change the Cap for particular institutions, and to grant exceptions.

COVERAGE OF DEPOSITS

The Final Rule does not significantly change the terms of the Transaction Account Guarantee Program, other than to expand coverage to certain NOW accounts and IOLTA and similar attorney trust accounts. Under the Final Rule, a NOW account may be covered by the Transaction Account Guarantee Program if the account has an interest rate equal to or less than 0.50 percent. The interest rate on such accounts may not exceed 0.50 percent at any time during the term of the Transaction Account Guarantee Program, and the insured depository institution must commit to maintain the interest rate at or below such level. If a NOW account has an interest rate exceeding 0.50 percent as of November 21, 2008, the account may still qualify for coverage if the insured depository institution readjusts the interest rate before January 1, 2009, and commits to maintain the interest rate at or below 0.50 percent.

The Final Rule also allows banks to continue to engage in "reclassification" or sweep programs where eligible noninterest-bearing transaction accounts are reclassified as, or swept into, noninterest-bearing "savings accounts," as defined by Federal Reserve Regulation D. This will enable banks to continue to reduce the amount of reserves required by the Federal Reserve, while maintaining the FDIC's Transaction Account Guarantee.

DISCLOSURES

Beginning on December 19, 2008, a participating entity that issues eligible debt must include a standard disclosure contained in the Final Rule indicating whether the debt is covered under the Debt Guarantee Program. Until December 19, a participating entity must disclose whether the debt is guaranteed in a "commercially reasonable manner." The first public debt issued under the Debt Guarantee Program has utilized the sample FDIC disclosures.

The Final Rule also includes uniform sample disclosure notices for participating and nonparticipating entities under the Transaction Account Guarantee Program. These notices are samples, however, and the form may be changed as long as the disclosure is simple and in readily understandable text. The Final Rule expands the disclosure obligations relating to reclassification of accounts to include both sweep arrangements not permitted under the Transaction Account Guarantee Program, and any "other action that results in funds being transferred or reclassified to an account that is not guaranteed." The Final Rule does not proscribe the form of disclosure required under these circumstances, only that it must be accurate, clear, and in writing.

Issuers of senior unsecured debt should carefully consider their disclosures of the Debt Guarantee Program's coverage, terms, duration, and effect upon any ratings of the debt, and make appropriate changes in the supplemental indentures to meet this Program's terms and facilitate claims upon the FDIC's debt guarantee.

FEES

The Final Rule keeps the 10 basis points annual fee for the Transaction Account Guarantee Program but alters the assessment structure imposed upon participating entities under the Debt Guarantee Program to better match FDIC guarantee assessments with debt maturities. The

assessment amount will be determined by multiplying the amount of FDIC-guaranteed debt times the term of debt (in years) times the following annualized assessment rates:

FDIC-Guaranteed Debt with a Maturity of	Annualized Assessment Rate (in basis points)
180 days or less (excluding overnight debt)	50
181-364 days	75
365 days or greater	100

The exclusion of short-term debt, including overnight debt, from the assessments makes the Debt Guarantee Program more attractive to all institutions, especially those whose only unsecured senior debt is federal funds.

An additional 10 basis point assessment will be applied to eligible holding companies and affiliates of an insured depository institution, if the affiliated insured depository institutions constitute less than 50 percent of the holding company's consolidated assets.

Participating entities must pay assessments starting November 30, 2008, for any senior unsecured debt issued on or after October 14, 2008, and on or before December 5, 2008, that is still outstanding on December 5, 2008, including debt (other than overnight debt) with maturities of less than 30 days. Starting December 6, 2008, assessments will be imposed upon senior unsecured debt with stated maturities of 30 days or more issued on or after December 6, 2008.

The assessment rates for debt issued above the Cap are double the assessment rates on all outstanding FDIC-guaranteed debt. No reductions in assessments are made if guaranteed debt is retired before its maturity.

PAYMENT OF CLAIMS

The Final Rule substantially clarifies the FDIC's obligations under the Debt Guarantee Program. The debt guarantee is now clearly stated as a full faith and credit obligation of the United States under Section 15(d) of the Federal Deposit Insurance Act. The FDIC's obligation under the Debt Guarantee Program is clearly stated as the timely payment of principal and interest upon an uncured payment default. Under the Interim Rule, the FDIC's obligation was not triggered until the insolvency of the participating entity. Upon an uncured payment default, the FDIC will continue making the covered entity's principal and interest payments timely as required under the applicable debt instrument and without regard to default or penalty provisions. The FDIC will not accelerate the debt. If the debt matures beyond June 30, 2012, however, the FDIC may elect at any time thereafter to pay the outstanding principal and interest in full. All claims for payment must be submitted to the FDIC within 60 days of default and must be accompanied by certain information, including evidence of a payment default and ownership of the FDIC-guaranteed debt.

Any debt holder making a claim under the Debt Guarantee Program must assign its rights in the debt to the FDIC, together with any claim it may have in an insolvency proceeding arising from FDIC-guaranteed debt. Once a claim is paid by the FDIC, the issuer is unconditionally liable to the FDIC for repayment of amounts paid by the FDIC. The payment must be made upon demand by the FDIC. If the issuer is placed into receivership or files for bankruptcy, then the FDIC will be considered a *bona fide* creditor. Further, all entities participating in the Debt Guarantee Program must execute and deliver to the FDIC a Master Agreement (available at www.fdic.gov) within five business days of an entity's election to continue participation under the Debt Guarantee Program. Pursuant to the Master Agreement, a participating entity (i) affirms the above-described arrangements, (ii) agrees to include provisions in its debt documents evidencing the above-described arrangements, (iii) agrees to reimburse the FDIC for any and all amounts expended in relation to a payment default, (iv) agrees to be bound by the terms and conditions of the Final Rule, including the reporting obligations and monitoring rights of the FDIC, and (v) makes representations and warranties regarding the status of its other reporting obligations and assessment payments to the FDIC.

The FDIC will consider the failure of an insured depository institution to make a payment on its outstanding debt that results in the FDIC becoming liable pursuant to its guarantee grounds for immediate closure and the appointment of

the FDIC as conservator or receiver. The FDIC will consider similar actions by a bank holding company as an unsound or unsafe practice that will subject the bank holding company to enforcement actions under Section 8 of the FDI Act.

IMMEDIATE EFFECTS OF THE FINAL RULE

The FDIC clarification that its guarantees under the Debt Guarantee Program are full faith and credit obligations of the United States to make timely payment of the interest and principal of FDIC-guaranteed debt have had immediate effects. S&P, Moody's, and Fitch each clarified their ratings for FDIC-guaranteed debt for the duration of the guarantee as follows:

	Short-Term	**Long-Term**
S&P	AAA	A-1+
Moody's	Backed - Aaa	Backed - Prime - 1
Fitch	AAA	F1+

The Wall Street Journal reported on November 28 sales of $17.25 billion of FDIC-guaranteed notes by two large issuers, with more expected to enter the market.

OTHER ISSUES

The FDIC will continue to maintain a list on its web site of eligible entities that have opted out of the Debt Guarantee Program or the Transaction Account Guarantee Program. Additionally, any entity participating in the Debt Guarantee Program is precluded from issuing nonguaranteed debt with a maturity arising before June 30, 2012, unless it exceeds the Cap or has opted to pay the FDIC a 37.5 basis points fee up front. Most importantly, however, the deadline for opting out of either the Debt Guarantee Program or the Transaction Account Guarantee Program remains 11:59 p.m., EST, December 5, 2008. Consequently, urgent action is required. The TLG Program Election Form is now available via FDIC*connect*.

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