FDIC Implements Temporary Liquidity Guarantee Program

November 20, 2008

On October 23, 2008, the Federal Deposit Insurance Corporation ("FDIC") announced that it had approved an interim rule, which was revised on November 7, 2008, to implement the Temporary Liquidity Guarantee Program ("TLG Program") that was established on October 14, 2008. In making its determination, the FDIC considered various economic factors, including unduly tightened lending standards and terms, decreased borrowing, rapid outflows of deposits, reduced issuances of commercial paper and asset- and mortgage-backed securities, decreased and costly alternative funding mechanisms and a lack of confidence in financial institutions based on embedded and uncertain balance sheet losses.

The TLG Program has two basic components: (1) the Debt Guarantee Program ("DGP"), through which the FDIC will guarantee the payment of certain newly-issued senior unsecured debt, and (2) the Transaction Account Guarantee Program ("TAGP"), through which the FDIC will guarantee certain noninterest-bearing transaction accounts at FDIC-insured institutions. The TLG Program is intended to preserve confidence and promote liquidity in the banking system in order to ease lending to creditworthy businesses and consumers, and to generally address the systemic risk identified by the FDIC.

Under the DGP, when private sources of capital are used to purchase debt securities of participating banking institutions, those securities will be guaranteed by the FDIC. This guarantee by the FDIC reduces the risk to investors, which, in turn, encourages investment in participating banks. The additional investment in the banks increases the availability of capital for the banks to lend, thereby pumping more capital into the economy and promoting market recovery and stabilization. The TAGP benefits banks, businesses and consumers who make payments, deposits and withdrawals from checking accounts on a regular basis at FDIC-insured institutions. The TAGP provides additional protection to ensure the free flow of funds into and out of the banks. With additional funds, the banks are likely to be better able to conduct daily business, which also contributes additional capital to the marketplace and further promotes market recovery and stabilization. Without the security provided by this additional insurance, those banks that may be perceived as weak or more likely to fail would be more likely to lose the business of customers that may be concerned about a failure, therefore perpetuating the decline and likely failure of those banks. By guaranteeing funds held in noninterest-bearing transaction accounts, the FDIC has acted to alleviate that uncertainty, which may decrease the likelihood of bank failures.

The TLG Program is a voluntary and time-limited program that will be funded directly through fees paid by participating entities (without any taxpayer funding). When the TLG Program expires, any funds remaining in the program after the FDIC has satisfied all claims asserted under each aspect of the TLG Program will remain in the Deposit Insurance Fund.

Eligibility and Participation

FDIC-insured depository institutions, U.S. bank holding companies or financial holding companies and certain U.S. savings and loan holding companies are eligible to participate in the TLG Program. Participation in the TLG Program was offered without cost to eligible entities for the first 30 days of the TLG Program (from its inception on October 14, 2008). Any eligible entity that does not wish to participate in either or both components of the TLG Program must notify the FDIC of its decision to opt out on or before December 5, 2008. Once the December 5, 2008 deadline has passed, the FDIC will post on its website a list of those entities that have chosen to opt out of either component of the TLG Program.

Debt Guarantee Program

The primary purposes of the DGP are to provide liquidity to the inter-bank lending market and promote stability in the unsecured funding market for banks. Beginning on December 19, 2008, any entity participating in the DGP must clearly disclose in writing to interested lenders and creditors what debt it is offering and whether the debt is guaranteed under this program. If guaranteed, the debt must be clearly identified as "guaranteed by the FDIC" and properly disclosed to creditors.

Under the DGP, the FDIC will guarantee all newly-issued senior unsecured debt, up to prescribed limits described in more detail below, that is issued by participating entities for the period from October 14, 2008 through June 30, 2009. This debt will be guaranteed until the earlier of (1) the maturity date of the debt or (2) June 30, 2012. If the issuing institution fails or if the issuing holding company files a bankruptcy petition during that time, the FDIC will pay any unpaid balance of the senior unsecured debt covered by the DGP. To be eligible for the DGP, the senior unsecured debt must be (1) non-contingent, (2) evidenced by a written agreement that contains a specified fixed principal amount to be paid on a certain date and (3) not subordinated to another liability.

If an entity decides to opt out of the DGP, the FDIC's debt guarantee expires on the earlier of December 5, 2008 or the date on which the entity decides to opt out. With respect to each eligible entity that does not opt out of the DGP, an annualized fee equal to 75 basis points multiplied by the amount of debt issued, and calculated for the maturity period of that debt (but not later than June 30, 2012), will be charged beginning on November 13, 2008. If a participating entity issues debt identified as "guaranteed by the FDIC" in excess of the limit established by the FDIC, the participating entity will have its assessment rate for guaranteed debt increased to 150 basis points on all outstanding guaranteed debt, and the participating entity will be subject to enforcement actions, as appropriate.

"Senior unsecured debt" includes purchased federal funds, 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 the bank, and excludes obligations from guarantees or other contingent liabilities, derivatives, derivative-linked products, debt paired with any other security, convertible debt, capital notes, the unsecured portion of otherwise secured debt, 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. Loans to affiliates, parents and subsidiaries, or to institution-affiliated parties, including controlling shareholders, directors and officers, are also excluded from the DGP.

The FDIC requires that each participating entity calculate and advise the FDIC of its outstanding senior unsecured debt as of September 30, 2008, even if the amount is zero. The FDIC will guarantee newly-issued unsubordinated debt for a maximum amount of up to 125 percent of the par or face value of senior unsecured debt outstanding, excluding debt extended to affiliates, as of September 30, 2008, that is scheduled to mature on or before June 30, 2009. If, following consultation with any appropriate federal banking agency, the FDIC determines it is necessary, the 125-percent limit may be adjusted for certain participating entities. Similarly, once an issuing entity has reached the 125-percent limit, it must specifically disclose that any debt issued over that limit is not guaranteed. Those who decide to participate in the DGP will be subject to FDIC onsite reviews as needed (in the discretion of the FDIC) and must supply the FDIC with all requested information.

The FDIC's responsibility to make a payment as guarantor of senior unsecured debt issued by participating insured depository institutions arises upon the failure of a participating insured depository institution. The FDIC will use the well-established receivership claims process to process guarantee requests, and the FDIC anticipates that payment will typically be made in the next business day following the failure. The FDIC will not consider any evidence provided by the debt holder that is not presented to the FDIC within 90 days after the publication of the claims notice by the receiver for the failed institution.

Under the DGP, the senior unsecured debt of holding companies is eligible for coverage when the holding company files for bankruptcy protection; following such bankruptcy filing, the FDIC will make payment to the debt holder for the principal amount of the debt and interest to the date of the filing of a bankruptcy petition by the issuing institution. The FDIC generally will not make a payment on the guaranteed amount for a 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.

To receive payment under the DGP, the holder of the unsecured debt is required to assign its rights, title and interest in the unsecured senior debt, and transfer its validated claim in bankruptcy, to the FDIC. This assignment must provide the FDIC with the right to receive principal and interest payments on the unsecured senior debt from the proceeds of the bankruptcy estate.

Transaction Account Guarantee Program

Under the TAGP, the FDIC provides a full guarantee for funds held at an FDIC-insured depository institution in noninterest-bearing transaction accounts above the existing deposit insurance limit. This guarantee is in addition to and separate from the coverage provided under the FDIC's general deposit insurance regulations. Coverage under the TAGP became effective on October 14, 2008, and will continue through December 31, 2009 (assuming the eligible institution does not opt out of the TAGP). Starting November 13, 2008, an eligible depository institution that does not opt out of the TAGP on or before December 5, 2008 will be charged, 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.

Beginning on December 19, 2008, every insured depository institution participating in the TAGP must disclose in writing its decision to participate in or opt out of the TAGP at its main office and all branches at which deposits are taken, and the disclosure must clearly state whether or not the institution's covered noninterest-bearing transaction accounts are fully insured by the FDIC. In addition, if the institution uses sweep arrangements or takes other actions that result in funds in a noninterest-bearing transaction account being transferred, or the account being reclassified as an interest-bearing or a non-transaction account, the institution must disclose those actions to the affected customers and advise them in writing that such actions will void the transaction guarantee.

A "noninterest-bearing account" is defined as "a transaction account, such as a corporate checking account, with respect to which interest is neither accrued nor paid and on which the insured depository institution allows for an unlimited number of deposits and withdrawals." A "transaction account" is a "deposit or account from which the depositor or account holder is permitted to make transfers or withdrawals by negotiable or transferable instrument, payment order of withdrawal, telephone transfer, or other similar device for the purpose of making payments or transfers to third persons or others or from which the depositor may make third party payments at an automated teller machine or a remote service unit, or other electronic device, including by debit card, but the term does not include savings accounts even though such accounts permit third party transfers." The term "noninterest-bearing account" includes traditional demand deposit checking accounts and official checks issued by an insured depository institution; however, it does not include negotiable order of withdrawal ("NOW") accounts or money market deposit accounts. Although the unlimited coverage for noninterest-bearing accounts under the TLG Program is intended primarily to apply to transaction accounts held by businesses (for example, payroll accounts), it also applies to all such accounts held by any depositor.

The FDIC will treat funds in sweep accounts in accordance with the currently existing rules and procedures for determining sweep balances at a failed depository institution. Under these procedures, funds may be swept or transferred from a noninterest-bearing transaction account to another type of deposit or non-deposit account. The FDIC will treat these funds as being in the account to which the funds were transferred. An exception will exist for funds swept from a noninterest-bearing transaction account to a noninterest-bearing savings account. Such swept funds will be treated as being in a noninterest-bearing savings account and will be guaranteed by the TAGP.

Any payments of claims under the TAGP will be made as soon as possible after the FDIC, in its sole discretion, determines whether the deposit is eligible and the amount that is ultimately guaranteed. In most cases, the FDIC will make the payment of such claim on the next business day following the failure of an institution that participates in the TAGP. For purposes of the TAGP, the failure of the participating institution is defined as the liquidation of, or other closing or winding up of the affairs of, any insured depository institution as set forth in 12 U.S.C. 1821(f). If there is no acquiring institution for a transaction account guaranteed by the TAGP, the FDIC will mail a check to the depositor for the full amount of the guaranteed account following the failure of the insured depository institution.

Conclusion

The TLG Program is only a temporary solution (*i.e.*, through December 31, 2009). The FDIC's intent is that the TLG Program will encourage and assist participating entities to ease lending to creditworthy U.S. businesses and consumers by federally backing sources of bank funding as well as protecting deposits in noninterest-bearing deposit transaction accounts. The FDIC is currently requesting comments on all aspects of the TLG Program, and there may be changes to the program based on those comments.

Duane Morris will be monitoring and commenting on the regulations, guidance and interpretations concerning the TLG Program and the Emergency Economic Stabilization Act ("EESA") as they become available.

For Further Information

If you have any questions regarding EESA or any of the programs described in this Alert, including how they may affect your company or its executives, please contact anymember of the Corporate Practice Group, any member of the Business Reorganization and Financial Restructuring Practice Group or the attorney in the firm with whom you are most regularly in contact.