DAVIS POLK & WARDWELL

Temporary Liquidity Guarantee Program: FDIC Final Rule

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On November 21, 2008, the FDIC released the Final Rule for its Temporary Liquidity Guarantee Program (the TLG Program), which guarantees certain senior unsecured debt issued by eligible banking institutions and provides unlimited deposit insurance through 2009 for certain transaction accounts. An Interim Rule implementing the TLG Program was published on October 23, 2008 and an amendment to the Interim Rule on November 7, 2008. The FDIC received numerous comments on the Interim Rule, and some of these comments, on matters such as revising the debt guarantee to a "payment when due" guarantee, charging lower assessments for guaranteed debt with shorter maturities and excluding short-term (30 days or less) debt from the guarantee, were incorporated into the Final Rule. Overall, these changes should improve the value of the guarantees provided under the TLG Program. Eligible institutions must decide by December 5, 2008 whether to stay in or opt out of all or part of the TLG Program. The FDIC estimates that $1.4 trillion of debt will benefit from the debt guarantee if all eligible institutions participate. An independent provider of financial market news expects $500 billion of guaranteed debt issuances during the next six months, most of which is debt maturity prior to June 30, 2009 that needs to be refinanced.

This memorandum is primarily designed to help eligible institutions understand the consequences of participation in the TLG Program, including the preparatory steps required to issue FDIC-guaranteed senior unsecured debt in the near future. To the extent necessary this memorandum also describes aspects of the TLG Program contained in the Interim Rule and its amendment. For further details on the Interim Rule, please see our prior memorandum. For the amendment to the Interim Rule, please see our client newsflash.

Important Dates

- **Both Guarantees**
  - **December 5, 2008 11:59 PM EST** – opt-out deadline
  - **December 19, 2008** – effective date for disclosure requirements ("adequate" disclosure "in a commercially reasonable manner" before then, but compliance with mandatory disclosure text advisable immediately)
- **Debt Guarantee**
  - **October 14, 2008** – first day for guarantee coverage of newly issued, senior unsecured debt
  - **December 5, 2008** – last day to opt in to long-term non-guaranteed debt option, and last day to report senior debt outstanding at September 30, 2008 and scheduled to mature on or before June 30, 2009 (with CFO or equivalent's certification)
  - **After December 5, 2008** –
    - ongoing issuance notifications to FDIC
    - monthly notifications of debt outstanding to FDIC (content and form yet to be determined)
  - **December 19, 2008** – last day to notify FDIC of debt issued on or after October 14 and still outstanding on December 5, 2008 under debt guarantee
  - **June 30, 2009** – last day to issue debt under debt guarantee
  - **June 30, 2012** – debt guarantee terminates
- **Transaction Account Guarantee**
  - **October 14, 2008** – first day for unlimited coverage
  - **December 31, 2009** – unlimited coverage ends

Overview of the Temporary Liquidity Guarantee Program

Core Features of the TLG Program

There are two parts to the TLG Program:

» A guarantee, through the earlier of maturity and June 30, 2012, of certain senior unsecured debt issued by participating institutions between October 14, 2008 and June 30, 2009 (the debt guarantee); and

» Unlimited deposit insurance through December 31, 2009 for certain transaction accounts at FDIC-insured participating institutions (the transaction account guarantee).

The debt guarantee, now in the form of a "payment when due" guarantee, still terminates on June 30, 2012. The Final Rule retains a limited opt-out, described in more detail below, for long-term debt.

Under the transaction account guarantee, the FDIC provides unlimited deposit insurance coverage for non-interest bearing transaction accounts at FDIC-insured participating institutions. This enhanced deposit insurance expires December 31, 2009. The Final Rule extends this coverage to certain types of interest-bearing accounts (NOW accounts with interest rates of 0.50% or less after December 31, 2008 and IOLTAs) under the transaction account guarantee.

All eligible institutions are deemed to participate in both guarantees unless they opt out of one or both programs. Institutions participating in the debt guarantee must execute a Master Agreement with the FDIC. The Master Agreement is described in more detail below.

Fees will be assessed on institutions participating in the TLG Program as described in more detail below. If the fees collected are inadequate to cover the TLG Program's costs after any FDIC recoveries from failed institutions' estates, the difference will be covered by an assessment on all FDIC-insured depository institutions.

Eligible Entities

- FDIC-insured banks and thrifts
- U.S. bank holding companies with an FDIC-insured subsidiary
- Certain U.S. savings and loan holding companies
- Designated affiliates, after consultation with the FDIC-insured institution's primary federal banking regulator, only for the debt guarantee
- Insured branches of non-U.S. banks may participate *only* in the transaction account guarantee
- All branches of foreign banks are excluded from the debt guarantee

Eligible Entities

Under the Final Rule, categories of institutions eligible to participate in the TLG Program include FDIC-insured depository institutions as well as U.S. bank holding companies and U.S. savings and loan holding companies, provided that, they have at least one chartered and operating FDIC-insured depository institution within their holding company structure (and, in the case of savings and loan holding companies, satisfy other conditions).

In addition, the FDIC, in consultation with an institution's primary federal banking regulator, may designate affiliates of FDIC-insured depository institutions as eligible entities for participation in the debt guarantee. To date, the FDIC has, to our knowledge, designated one such affiliate, General Electric Capital Corporation (GECC). As part of GECC's becoming an eligible entity, it entered into an agreement with the FDIC establishing, among other things, that GECC would be subject to FDIC oversight and reporting requirements relating to the TLG Program. We expect that others applying to become eligible entities will have to sign similar agreements, and the FDIC has indicated that it will consider the extent of the financial activities of the entities in the related holding company's structure, the ratings strength of the affiliate and the "size and extent of the activities of the organization" in determining whether to grant eligible entity status. In connection with designating an affiliate of a participating entity as an eligible entity, the FDIC will also establish that entity's debt guarantee limit.

Insured branches of non-U.S. banks may participate only in the transaction account guarantee. Uninsured U.S. branches and agencies of non-U.S. banks remain excluded from participation in both parts of the TLG Program.

An institution that becomes an eligible entity after October 13, 2008 may participate in the TLG Program if approved by the FDIC in consultation with that institution's primary federal regulator. The amount of guaranteed debt such an entity may issue will be determined by the FDIC on a case-by-case basis.

Key Points on the Debt Guarantee

- “Payment when due” guarantee
- Debt maturing on or before June 30, 2012 is assigned highest ratings based on strength of FDIC guarantee
- SEC has granted no-action relief exempting debt securities guaranteed under the TLG Program that mature on or before June 30, 2012 from registration under Section 3(a)(2) of the Securities Act
- Guarantee does not cover short-term (30 days or less or “one month”) debt issued after December 5, 2008
- Exceeding debt guarantee limit results in penalties; once limit reached, issuances must be disclosed as non-guaranteed
- Participating institutions retain the option to issue non-guaranteed senior debt with maturity date after June 30, 2012 against up-front fee
- Tiered fees based on guaranteed debt’s maturity

Election and Opt-out Period

All eligible institutions, including those already participating in the TLG Program, must make an election decision to opt in or out of both guarantees of the TLG Program on or before December 5, 2008. The TLG Program Election Form, available via the FDIC’s secured website (FDIC*connect*) as of November 24, 2008, must be submitted to the FDIC regardless of whether an institution is opting in or out. Even though the nine systemically important bank holding companies have already agreed to participate in the TLG Program, they will still be expected to submit the Election Form accompanied by certain CFO-certified information.

> All eligible entities, including those already participating in the TLG Program, must submit an Election Form on or before December 5, 2008

As previously reported, all entities in a bank or thrift holding company structure must make the same opt-out election for each part of the TLG Program, and are deemed to have opted out if their elections differ. Institutions that are not insured depositories need to make their election through an affiliated FDIC-insured depository institution. If an eligible institution fails to opt out or affirmatively opts in to one or both of the guarantees, participation in that guarantee becomes mandatory. Participation levels in the debt guarantee will likely reflect the market’s greater acceptance of the guarantee structure presented in the Final Rule.

The Master Agreement

The FDIC has published the Master Agreement that institutions must enter into with the FDIC to participate in the debt guarantee. No guaranteed debt may be issued after November 21, 2008, unless the participating institution agrees to be bound by the terms of the Master Agreement. The Master Agreement requires the institution to enter into certain covenants (including promises to reimburse the FDIC); waive certain defenses; adopt certain mandatory terms for its guaranteed debt; make standard representations and warranties and comply with the Master Agreement’s notice requirements. These obligations are in addition to a participating institution’s obligations under the Final Rule.

The Master Agreement must be signed as of the date of an institution's election to continue participating in the debt guarantee and be submitted within 10 business days of that election date. As a practical matter, institutions that issue guaranteed debt after November 21, 2008 but before the above due date for the Master Agreement may want to consider signing the Master Agreement at or prior to the launch of their first guaranteed debt issuance since by issuing the debt they are already agreeing to be bound by the Master Agreement's terms.

For guaranteed debt issued after November 21, 2008, participating institutions must agree to terms of the Master Agreement

Senior Unsecured Debt

- **Maturity must be greater than 30 days or "one month" for debt issued after December 5, 2008**
- **Must contain terms set forth in the Master Agreement, unless evidenced by a trade confirmation**
- **Examples of Instruments Included:**
  - federal funds purchased
  - promissory notes and commercial paper
  - unsubordinated unsecured notes, including zero coupon bonds
  - bank deposits in an international banking facility of an insured depository institution
  - U.S. dollar-denominated CDs owed to certain institutions
- **Examples of Instruments Excluded:**
  - retail debt securities (*i.e.*, marketed exclusively to retail investors)
  - obligations from guarantees or other contingent liabilities
  - derivatives or derivative-linked products
  - debt paired with any other security
  - unsecured portion of otherwise secured debt
  - negotiable CDs
  - most foreign deposits
  - loans from affiliates
  - trust preferred securities

Terms of the Debt Guarantee

Senior Unsecured Debt

Only debt with a maturity greater than thirty days or "one month" is covered by the debt guarantee (with one exception for short-term debt issued as guaranteed debt before the Final Rule).

On the *types* of debt that can be guaranteed, the Final Rule provides non-exhaustive lists of instruments which are and are not included in "senior unsecured debt" (see sidebar). One excluded debt type added in the Final Rule should be noted: "retail debt securities", which the FDIC has clarified are securities marketed *exclusively* to retail investors, typically in small denominations. Debt that is more broadly marketed, even if it is subsequently held by retail investors through secondary market trading, is eligible for the debt guarantee.

> Debt with a maturity of thirty days or less issued after December 5, 2008 is excluded from the guarantee

Senior unsecured debt must also meet certain legal and structural requirements, including:

- it cannot contain any embedded options or other derivatives;
- it must be evidenced by a written agreement or a trade confirmation;
- it must contain a specified and fixed principal amount to be paid on a date certain (excluding, *e.g.*, revolving credit agreements); and
- it must be non-contingent and not subordinated by its terms to another liability.

Senior unsecured debt may pay a fixed or floating interest rate based on a single index (T-bill, prime, or LIBOR), may be denominated in foreign currency (except for deposits), and may contain a negative pledge clause.

The Final Rule eases the Interim Rule's requirement of a "written agreement" by allowing guaranteed debt to be evidenced by a trade confirmation. Some logistical issues have yet to be resolved for such trade confirmation debt. Most

notably, the institution issuing such debt must use commercially reasonable efforts to have its counterparties execute a written instrument evidencing their agreement to be bound by the terms of the Master Agreement.

Debt issued by a participating institution to that institution's affiliates, institution-affiliated parties or insiders is excluded from the debt guarantee, as the FDIC does not believe that guaranteeing such issuances is a means of enhancing inter-bank lending.

Finally, in order to qualify for the debt guarantee, senior unsecured debt must contain certain contractual terms as specified in the Master Agreement.

Mandatory Debt Terms

The Master Agreement mandates the inclusion of certain provisions in all guaranteed debt offerings. Under the Master Agreement, participating institutions covenant not to modify certain terms of the guaranteed debt, including, but not limited to, provisions related to the principal, interest, payment, default or ranking of the guaranteed debt, without the express written consent of the FDIC.

On disclosure, the Master Agreement requires all governing documents (indentures, notes, etc.) of a guaranteed offering to include the phrase "this debt is guaranteed under the FDIC Temporary Liquidity Program and is backed by the full faith and credit of the United States" and other disclosure language.

In addition to the mandated disclosure, the governing documents for guaranteed debt issuances are required to designate a representative (typically the indenture trustee, paying agent or equivalent) for purposes of making claims for the debtholders under the guarantee, set forth the terms of the FDIC's subrogation, include the required assignment of claims and provide for the surrender of the debt's certificate or similar instrument.

Finally, debt documents cannot include terms that would result in the automatic acceleration of guaranteed debt upon the issuer's default on any of its debt while the guarantee is in effect or the FDIC is making guarantee payments.

FDIC Payment of Claims Under the Debt Guarantee

To the relief of institutions participating in the debt guarantee, and in response to comments received, the Final Rule scrapped the cumbersome and time-

FDIC Claim Payments Under the Debt Guarantee

- **FDIC's Guarantee Obligation: upon uncured payment default, timely payments of principal and interest until maturity (with an option to accelerate after June 30, 2012)**
- **Demand notice: the representative or debtholder(s) must make a demand for payment within 60 days to receive any guarantee payment from the FDIC. For the debt to qualify for Standard & Poor's AAA rating, demand must be made "upon the uncured failure of the issuer."**
- **Recoupment: participating institutions are liable to the FDIC for any guarantee payments the FDIC makes to noteholders, as set forth in the Master Agreement**

consuming claims payment process as proposed in the Interim Rule and replaced it with a relatively straightforward "payment when due" process which applies equally to all participating institutions, whether or not they are FDIC-insured. The revised guarantee more closely resembles its U.K. counterpart, and has led the three major rating organizations to rate debt issued under the TLG Program with their respective highest ratings.

Payment Obligation

The FDIC's payment obligation for guaranteed debt occurs on the uncured failure of a participating institution to make a timely payment of principal or interest, as defined in the debt's governing documents (referred to as a payment default) on its debt guaranteed under the TLG Program.

> Upon a payment default, the FDIC will make scheduled payments of principal and interest through maturity, subject to its option to accelerate after June 30, 2012

The Master Agreement requires an institution to report within one business day any default in payment on *any of its indebtedness* (including debt not covered by the guarantee), without giving effect to any cure period, if that default in payment would or would reasonably be expected to result in default on guaranteed debt. Furthermore, it must require the representative to notify the FDIC of any payment default under the guaranteed debt. Once a payment obligation is triggered, the representative or, in certain cases, individual debtholders, have 60 days to submit a demand notice to the FDIC or they lose all rights under the FDIC guarantee. This demand notice must include an assignment of the debtholders' rights under an insolvency proceeding of the participating institution, including any and all distributions on the debt from the receivership or bankruptcy estate. As described below, Standard & Poor's has suggested that more stringent demand requirements will be necessary if the guaranteed debt is to qualify for its AAA rating.

Satisfaction of the Payment Obligation

Upon a payment default, and a delivery of a timely and conforming demand notice, the FDIC will make scheduled payments of principal and interest on the

FDIC's Rights Upon Payment

- **The FDIC has two means of recovering from a defaulting institution:**
  - assignment or subrogation;
  - make-whole reimbursement payments
- **Indebtedness to the FDIC arising out of make-whole payments is an unsecured obligation of the institution ranking *pari passu* with existing senior unsecured debt**

guaranteed debt through maturity. Under the Master Agreement, guarantee payments will be paid directly to the representative or, in the absence of a representative or for those opting not to be represented, directly to the registered holders, never to the issuing institution. If guaranteed debt matures beyond the guarantee cutoff date of June 30, 2012, and the issuing institution defaults prior to the cutoff date, the FDIC may, at its option, accelerate the indebtedness after June 30, 2012 and make a final payment of all principal and interest due without being liable for any prepayment penalty. The FDIC is not obligated to pay any additional amounts under any default or penalty provisions of the guaranteed debt. By accepting payment from the FDIC, debtholders release the FDIC from any further claim under the TLG Program. Any determination by the FDIC regarding the payment process may be appealed in court within 60 days of the determination.

Recoupment Mechanisms on a Payment Default

The FDIC may recover guarantee payments made to debtholders through subrogation or assignment. The Master Agreement requires that the governing documents of guaranteed debt provide that upon payment under the guarantee the FDIC will be subrogated to the debtholder's rights against the institution for any amounts paid and that the debtholder or representative must also execute an assignment of all of its rights to the FDIC, including the right to receive payments.

In addition, the defaulting institution is required to reimburse the FDIC for guarantee payments, including interest on unpaid reimbursement obligations, at the rate of the guaranteed debt instrument plus 1%, and for any reasonable expenses. Pursuant to the Master Agreement, participating institutions agree to a general waiver of claims and further waive any defenses to payment obligations under guaranteed debt until all make-whole payments have been received by the FDIC.

Determining the Debt Guarantee Limit

- **"125% test":** a participating institution's debt guarantee limit is 125% of its senior debt outstanding at September 30, 2008 scheduled to mature before June 30, 2009
- **If a participating institution has no debt outstanding (or only federal funds purchased) on September 30, 2008, then:**
  - if the participating institution is an FDIC-insured depository institution: its debt guarantee limit is 2% of its consolidated total liabilities at September 30, 2008;
  - otherwise: the participating institution must request the FDIC to establish a debt guarantee limit

Debt Guarantee Limit

Except as described below, the maximum amount of FDIC-guaranteed debt a participating institution may issue is 125% of the par or face value of the institution's senior unsecured debt outstanding as of the close of business on September 30, 2008 scheduled to mature before June 30, 2009. "Senior unsecured debt" has the same meaning in the context of the debt guarantee limit for eligibility purposes discussed above, except that debt with a maturity of 30 days or less is included when determining the debt guarantee limit. For debt issued in a foreign currency, the exchange rate in effect on the date the debt is funded is used for purposes of calculating the amount of debt outstanding in determining the debt guarantee limit.

Debt with a maturity of thirty days or less is included in the debt guarantee limit computation

Alternatives to the 125% Test

For an otherwise eligible insured depository institution with no qualifying debt (or only federal funds purchased) outstanding at September 30, 2008, the debt guarantee limit is 2% of its consolidated liabilities at September 30, 2008. Participants that are not insured depository institutions with no qualifying debt and institutions that become eligible after October 13, 2008 must submit a written application to the FDIC for a debt guarantee limit, including a discussion of the institution's financial condition, supervisory history, the size of its activities and its ratings strength. The FDIC will determine the debt guarantee limit for such an entity. A participating entity may also request an increase in its debt guarantee limit by written request to the FDIC. The FDIC retains the discretion, in consultation with the participating institution's primary federal banking regulator, to increase or decrease the participating institution's debt guarantee limit, once established, on a case-by-case basis, and to impose other limits or requirements.

Corporate Structure and the Debt Guarantee Limit

The debt guarantee limit is calculated for each participating institution. Entities that are not insured depository institutions are limited to their own individual caps; however, an insured depository institution may issue debt under both its debt guarantee limit and the debt guarantee limits of any of its participating parents, absent contrary direction by the FDIC. To do so, an insured depository institution must provide written notice to the FDIC and any participating parent indicating the amount of the increase, the name of each contributing participating parent, and the starting and ending dates of the increase. Increases in the insured depository institution's limit are offset by reductions in the relevant participating parents' debt guarantee limits.

In the event of a merger of eligible entities, the surviving institution's debt guarantee limit is the sum of the debt guarantee limits of the merging entities, subject to FDIC action following consultation with the surviving institution and the appropriate federal banking agency.

Exceeding the Debt Guarantee Limit

No debt issued by a participating institution in excess of its debt guarantee limit may be identified as FDIC-guaranteed. If a participating institution exceeds its debt guarantee limit and mistakenly or intentionally issues excess debt identified as guaranteed by the FDIC, the FDIC's assessments on all of the participating institution's outstanding guaranteed debt are increased by 100%. The FDIC can reduce the 100% assessment increase if a participating institution shows good cause for an issuance of guaranteed debt beyond its debt guarantee limit. Representing debt as guaranteed when issued in excess of the debt guarantee limit may subject the issuer to enforcement actions and civil money penalties, including termination of the institution's participation in the debt guarantee program. A termination is solely prospective and all previously issued guaranteed debt remains guaranteed. From the debtholder's perspective,

An insured depository institution may issue debt under both its debt guarantee limit and the debt guarantee limit of any of its participating parents

Fees Under the Debt Guarantee

- ***Annualized Assessment on Guaranteed Debt*:**
  - debt with maturity of "one month" or 30 days or less: not guaranteed and no fee if issued after December 5, 2008;
  - debt with maturity of 180 days or less: 50 bps;
  - 181-day to 364-day maturity debt: 75 bps; and
  - debt with maturity of 365 days or more: 100 bps
- **Additional 10 bps charge on guaranteed debt for holding companies and affiliates other than insured depository institutions if combined assets of all affiliated depository institutions are <50% of consolidated holding company assets**
- **100% increase on *all* guaranteed debt if the debt guarantee limit is exceeded, but can be lowered upon showing of good cause**
- **For those institutions that choose the long-term non-guaranteed debt option, 37.5 bps of 100% of all senior unsecured debt outstanding at September 30, 2008 with a maturity date on or before June 30, 2009**
- **No fees on those who opt out by December 5, 2008**

the FDIC has stated that debt issued in excess of the debt guarantee limit is protected if the holder received the required guarantee disclosure.

Participating institutions will need to establish operational and compliance procedures to track outstanding guaranteed debt both for disclosure purposes and to monitor their debt guarantee limit.

The Debt Guarantee Limit and the CPFF

The Federal Reserve's Commercial Paper Funding Facility (CPFF) applies to certain three-month commercial paper. Participating institutions should note that their issuance of commercial paper counts towards their maximum issuance amount under the debt guarantee, and that the FDIC will assess fees on such issuances if their paper has a greater than 30-day maturity, even though they may believe that participating in the CPFF obviates the need to use and pay for the FDIC guarantee. Institutions whose short-term debt rating will improve to at least A-1/P-1/F1 as a result of the FDIC guarantee might want to explore whether to also participate in the CPFF, which was not previously available to them. Institutions having access to the CPFF and who participate in the TLG Program will want to determine when to issue longer-dated debt in order to profit from the FDIC guarantee through June 30, 2012, given that the CPFF is currently scheduled to stop purchasing commercial paper on April 30, 2009, unless extended by the Federal Reserve.

Debt Guarantee Fees

Fees for the debt guarantee will be assessed at an annualized rate multiplied by the amount of eligible debt issued and the debt's term. The applicable annual rate varies depending on the maturity of the debt (see sidebar).

Bank holding companies and affiliates other than insured depository institutions whose combined assets in all affiliated insured depository institutions constitute less than 50% of the consolidated holding company's total assets are subject to an additional 10 bps assessment, resulting in 60, 85, and 110 bps fees. The asset comparison test to determine whether an eligible entity is subject to the add-on fee is determined as of September 30, 2008, or the date of eligibility if after October 13, 2008. This add-on fee is expected to predominantly affect recently created bank holding companies.

Fees must be paid on the first business day after the notice of issuance is given to the FDIC and the corresponding invoice is posted on FDIC*connect*. The designated account of an affiliated insured depository institution is the account through which all assessments will be paid to the FDIC for all members of a group that are not themselves insured depository institutions. To avoid violations of Section 23A of the Federal Reserve Act regarding covered transactions with affiliates, bank holding companies are expected to fund their affiliated insured depository institutions' Automated Clearing House ("ACH") account in advance of the FDIC's collection of assessments through direct debit.

Fees are not refundable for debt retired before its stated maturity. No fees will be incurred on guaranteed debt issued before December 5, 2008, unless the debt is still outstanding after December 5, 2008, in which case the fees accrue retroactively from November 13, 2008. For guaranteed debt issued on or after December 6, 2008, fees accrue from the date of issuance. Any institution that chooses to opt out of the program on or before December 5, 2008 will pay no fees.

Despite numerous comment letters seeking the option to issue non-guaranteed debt maturing within the guarantee period, participation in the debt guarantee is "all or nothing" aside from the Long-Term Non-Guaranteed Debt Option

Long-Term Non-Guaranteed Debt Option

Participation in the debt guarantee continues to be "all or nothing" – all newly issued senior unsecured debt with appropriate maturity will be guaranteed, and an institution cannot issue non-FDIC-guaranteed qualifying senior debt until it has issued the maximum amount of guaranteed debt it is allowed at any point in time – except for the "long-term non-guaranteed debt option". If an institution elects this option, it may issue non-FDIC-guaranteed senior unsecured debt with a maturity date after June 30, 2012 at any time, in any amount and without regard to the debt guarantee limit for that institution. Institutions must elect this option by December 5, 2008. Upon election, the institution must pay a non-refundable fee, collected in six equal installments, equal to 37.5 bps of the institution's senior unsecured debt outstanding at September 30, 2008 with a

maturity date on or before June 30, 2009 or, if the institution has no such debt, 37.5 bps of the institution's otherwise determined debt guarantee limit (as described above). This non-refundable fee will be applied to offset the institution's debt issuance fees to the FDIC for guaranteed debt, if any, until the non-refundable fee is exhausted.

Restrictions on Use of Proceeds

The FDIC has declared that the debt guarantee should help to ensure that institutions are able to replace pre-existing, senior unsecured debt as it comes due, but not earlier. Under the Final Rule, proceeds from the issuance of guaranteed debt cannot be used to prepay debt that is not FDIC-guaranteed.

On-Lending

There is no express requirement that the funds raised from FDIC-guaranteed debt be used to grant loans. Participants should nonetheless bear in mind the FDIC's statement that the TLG Program is intended to enhance liquidity and that the FDIC is encouraging eligible entities to use the capital raised to engage in prudent lending. Moreover, in a recent Interagency Statement on Meeting the Needs of Creditworthy Borrowers, the federal banking agencies expressed their view that all banking organizations must fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers.

Rating

The three major rating agencies have announced they will generally provide the same rating given to U.S. government debt for debt guaranteed under the TLG Program scheduled to mature on or before June 30, 2012. In light of the Final Rule's criteria of "unconditional, irrevocable and timely" payment, backed by the "full faith and credit of the U.S. government", Moody's Investors Service and Fitch Ratings have announced that they will assign backed-Aaa and backed-Prime-1 ratings

The three major rating agencies will provide the same rating given to U.S. government debt to guaranteed debt scheduled to mature on or before June 30, 2012

(Moody's) and AAA/F1+ (Fitch) long-term and short-term ratings, respectively, to the debt issues that carry a guarantee under the TLG Program where the maturity of the debt is on or before June 30, 2012. Standard & Poor's has stated it will assign debt guaranteed under the TLG Program the same rating as U.S. government obligations (AAA for long-term debt or A-1+ for short-term debt), so long as the representative is "required to demand payment . . . upon the uncured failure by the issuer to make a timely payment." In our view, in order to ensure receiving the highest rating from Standard & Poor's, the representative should be required to deliver its demand notice upon the earlier of the date that the applicable cure period ends and 60 days following the payment default.

All three rating agencies have indicated that the guarantee will not affect ratings assigned to debt issuances with a maturity beyond June 30, 2012. For entities that opt out of the debt guarantee, Fitch has said that it will individually review each case on its merits and does not envision that non-participants will face negative pressure solely as a result of their decision to opt out. Moody's views the debt guarantee positively for Bank Financial Strength Ratings as well as for banks' non-guaranteed debt issues, as it should restore market confidence – at least during the guarantee period – in the institutions' liquidity.

Risk Weighting, Collateral and Debt Index

Senior unsecured debt that is guaranteed under the TLG Program will have a risk weighting of 20% as, according to the FDIC, the purpose of the TLG Program is to encourage liquidity in the market, not to provide bank capital relief. We expect that guaranteed debt will be accepted as collateral by the Federal Reserve. FDIC-guaranteed debt will be classified as "government guaranteed" in Barclays' Global Family of Indices.

Guaranteed debt has a 20% risk weighting

FDIC Reporting Required Under the Debt Guarantee

» **By December 5, 2008:**

- report debt forming basis for calculating debt guarantee limit on Election Form, even if it is zero

» **For each guaranteed debt issuance after December 5, 2008:**

- institution must notify the FDIC of issuance;
- CFO or equivalent must certify that issuance does not exceed guaranteed limit

» **On or before December 19. 2008:**

- report issuances of guaranteed debt on or after October 14, 2008 that are still outstanding on December 5, 2008

» **Institution must report information on outstanding guaranteed debt on a monthly basis**

FDIC Reporting Required by the Debt Guarantee

In addition to the FDIC's publication of the lists of those institutions which opt out of the TLG Program, institutions participating in the debt guarantee must file certain notifications and ongoing reports with the FDIC under the Master Agreement and the Final Rule. All reports to the FDIC concerning debt issuances or balances outstanding must state whether the institution has exceeded its debt guarantee limit at any time since the previous report and must contain a certification by the institution's CFO or equivalent on the accuracy of the information reported.

No guaranteed debt may be issued after December 5, 2008 unless notice is given to the FDIC

No guaranteed debt may be issued after December 5, 2008 unless notice is given to the FDIC within a time period to be specified by the FDIC. The FDIC will publish further procedures governing these notice and certification requirements.

Reporting Due on or Around the Opt-out Deadline

Each institution participating in the debt guarantee must report the amount of its senior unsecured debt forming the basis for its debt guarantee limit no later than December 5, 2008, even in the event that the amount of such senior unsecured debt is zero. This disclosure is part of the TLG Program Election Form that has been made available on FDIC*connect*.

By December 19, 2008, any institution participating in the debt guarantee must also notify the FDIC of any guaranteed debt it issued from October 14, 2008 that is still outstanding on December 5, 2008, including a certification that the issuances have not exceeded the institution's maximum guaranteed amount.

Reporting Due at Each Guaranteed Debt Issuance

For any issuance of guaranteed debt after December 5, 2008, the participating institution must notify the FDIC of the issuance via FDIC*connect* and provide a certification that the debt issued does not exceed the participating institution's debt guarantee limit. The form and timing for such reports have not yet been specified.

Reporting Due on an Ongoing Basis, Including Monthly Reports

Pursuant to the Master Agreement, participating institutions must provide the FDIC with monthly reports during the guarantee period, in a form to be specified by the FDIC, and provide additional information relating to such outstanding debt as reasonably requested by the FDIC within ten business days of the receipt of such a request.

Participating institutions must notify the FDIC in writing within one business day of any payment default with respect to any of the participating institution's indebtedness that would or would reasonably be expected to result in an event of default under any of the institution's guaranteed debt. The representative of holders of guaranteed debt will also be required to provide notice to the FDIC of any payment default under the guaranteed debt pursuant to the mandatory terms set out by the Master Agreement.

Disclosure Mandated by the Debt Guarantee

- **Disclosure required for institutions that have opted out:** none required
- **Disclosure required for institutions participating in the debt guarantee:**
  - must clearly identify the debt as either guaranteed or not guaranteed; and
  - mandatory disclosure language provided in the Final Rule must be used for all issuances beginning on December 19, 2008 (but, as a practical matter, should be used for all issuances before then)
- **Documents governing guaranteed debt must include acknowledgement by parties that the issuer has not opted out, and, as a result, the debt is guaranteed**

Disclosure to Market Participants Mandated by the Debt Guarantee

Institutions participating in the debt guarantee will be required to make disclosures to potential lenders or customers, and comment letters to the Interim Rule sought FDIC guidance on these disclosure obligations. In response, the Final Rule now provides mandatory disclosure language for institutions participating in the debt guarantee.

Disclosure to Potential Lenders and Investors on Each Issuance of Guaranteed Debt

Each institution participating in the debt guarantee must include a specific disclosure statement in all written materials provided to lenders or creditors regarding guaranteed debt issued on or after December 19, 2008, including a statement that "[t]his debt is guaranteed under the FDIC Temporary Liquidity Guarantee Program and is backed by the full faith and credit of the United States".

Although the Final Rule requires any institution to include this disclosure language in "all written materials" provided to lenders or creditors, the discussion in the Final Rule describes it as required in "all written materials *underlying*" the debt, and the extent to which the language will be included in the numerous ancillary documents in a debt offering may be worked out in practice and in discussion with the FDIC. The Master Agreement requires that all governing documents for the issuance of guaranteed debt include an acknowledgment between the parties that the issuing institution has not opted out, and, as a result, the debt being issued is covered by the TLG Program.

For debt issued before December 19, 2008, the Final Rule only requires that "adequate" disclosure be made in a "commercially reasonable" manner. No guaranteed debt may be issued after November 21, 2008, however, unless the participating institution agrees to be bound to the terms of the Master Agreement. Therefore, participating institutions will have to determine whether to treat both the Final Rule's disclosure guidelines and the terms mandated by the Master Agreement as being effective immediately.

Disclosure to Potential Lenders and Investors at Each Issuance of Non-Guaranteed Debt

When issuing debt that is not guaranteed by the TLG Program, an institution participating in the debt guarantee must include disclosure to that effect. The Final Rule provides a mandatory disclosure statement clearly identifying that the "debt is not guaranteed under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program". As with the mandatory language for guaranteed debt, the Final Rule requires that this language be included in all written materials provided to potential lenders or creditors, while the discussion in the Final Rule release only specifies that the language is to be included in written materials underlying the debt.

Practice Pointers for Issuances of Guaranteed Debt

Institutions may wish to issue guaranteed debt in the form of credit facilities (other than revolving credit facilities, which are not covered under the TLG Program) or capital markets issuances on a registered or unregistered basis. In all cases, we expect that lenders, underwriters and issuers will:

- In the case of debt issued before December 5, 2008, include a covenant that the institution has opted into, or will not opt out of, the program, and has delivered or will deliver a completed and executed copy of the signature page of the Master Agreement within ten business days of submitting its Election Form to the FDIC; at a practical level, issuers deciding whether to come to market before December 5, 2008 will have to consider whether it would be prudent to opt in and sign the Master Agreement in connection with their first guaranteed debt offering rather than to exhaust the time limits available to them;

- Undertake appropriate due diligence as to the institution's previous issuance history to ensure that the debt will be guaranteed and not exceed the limits;

- Include a covenant that the proceeds will not be used to prepay non-guaranteed debt;

- Include a covenant that the debt is not being marketed and targeted exclusively to retail investors;
- Include a covenant to ensure that FDIC fees are paid when due and in the manner proscribed by the Final Rule, and, in addition, consider whether to impose a condition precedent to closing that those fees are paid before closing;

Terms of guaranteed debt cannot result in the automatic acceleration of the debt upon default for as long as the guarantee is in effect or guarantee payments are being made

- Include the provisions required by the Master Agreement in the guaranteed debt's governing documents, including the topics discussed earlier in this memorandum;
- To ensure that Standard & Poor's assigns a AAA rating to the guaranteed debt, require the representative to demand payment from the FDIC "upon the uncured failure" by the issuer, and not merely within 60 days;
- Ensure there are no debt provisions, such as one that would result in the automatic acceleration of the guaranteed debt upon a default by the issuer for as long as the guarantee is in effect or guarantee payments are being made, that would violate the Master Agreement's terms; and
- Work together to ensure that the debt is not placed with any affiliates, insiders or insiders of affiliates of the issuer.

Capital markets offerings will tend to contain additional conditions because the FDIC guarantee is itself considered a "security" that is being offered in connection with the capital markets transaction:

- Because the FDIC is an agency of the United States, the guarantee is exempt from registration under the Securities Act of 1933;
- Pursuant to an SEC No-Action Letter dated November 24, 2008, debt securities guaranteed under the TLG Program that mature on or before June 30, 2012 are also exempt from registration under Section 3(a)(2)

of the Securities Act, as securities guaranteed by an instrumentality of the United States;

- We do not expect that institutions will include any significant disclosure about the FDIC in their offering documents, given that the FDIC is an agency of the United States; and

- In light of the fact that guaranteed securities with a maturity up to June 30, 2012 will be rated at the highest short-term or long-term debt rating by each of the three major rating agencies on the strength of the FDIC guarantee, and the above-mentioned exemption from registration, it is unlikely that reasonable investors will view information about the issuer as material to their investment decision; underwriters will therefore need to decide what level of due diligence to conduct on issuers of guaranteed debt.

Underwriters will need to decide what level of due diligence to conduct on issuers of guaranteed debt

Non-interest Bearing Transaction Accounts

» **Characteristics:**

- interest is neither accrued nor paid (except in the case of IOLTAs and NOW accounts)
- the institution does not reserve the right to require advance notice of an intended withdrawal
- funds are held in U.S.-based accounts

» **Examples of accounts included:**

- IOLTAs
- negotiable order of withdraw (NOW) accounts that have an interest rate, from January 1, 2009 onwards, of 0.50% or lower
- payroll accounts
- traditional demand deposit checking accounts
- official checks issued by an insured depository institution
- sweeps into certain non-interest bearing accounts
- escrow accounts if they are non-interest bearing transaction accounts

» **Examples of accounts excluded:**

- interest bearing money market deposit accounts
- Interest bearing accounts offering zero interest

The Transaction Account Guarantee

Coverage

The transaction account guarantee provides an unlimited guarantee through December 31, 2009 for funds held at FDIC-insured participating institutions in non-interest bearing transaction accounts. The transaction account guarantee is intended to cover payment-processing (*e.g.*, payroll) and other similar non-interest bearing accounts, as well as two types of interest-bearing accounts: NOW accounts (provided that, by no later than January 1, 2009, the interest rate paid on such accounts is 0.50% or lower) and Interest on Lawyer Trust Accounts (IOLTAs) (or accounts functionally equivalent to IOLTAs). Sweep accounts are excluded, except for sweeps from one non-interest bearing transaction account to a non-interest bearing savings account, non-interest bearing money market deposit account or any other non-interest bearing transaction account. For an extended list of certain included and excluded accounts, please see the sidebar.

Calculation of Fees

The fee assessed to FDIC-insured participating institutions continues to be an annualized 10 bps on balances in non-interest bearing transaction accounts that exceed the $250,000 FDIC deposit insurance limit, as determined on a quarterly basis by reference to the institution's call reports or equivalent. Accounts with pass-through coverage will, according to the FDIC, be assessed considering each beneficiary's balance separately.

Payments in Receivership

The FDIC's payment obligations in connection with the transaction account guarantee follow established procedures. The FDIC is generally required to pay claims of depositors holding non-interest bearing transaction accounts "as soon as possible" upon the failure of the institution. In most cases, the FDIC expects payment to be made within one business day following a participating institution's failure, by making a new insured deposit of like amount available at another insured depository institution. If the account cannot be transferred to another insured depository institution, the FDIC will mail a check for the full amount of the guaranteed deposit "within days". Although the FDIC retains the

discretion to require a depositor to file a proof of claim, the FDIC has stated that it does not anticipate that a proof of claim will ordinarily be required.

Disclosure Requirements

Every FDIC-insured depository institution that offers non-interest bearing transaction accounts must provide, in the lobby of its main office and its domestic branches and, if it offers Internet deposit services, on its website, a notice of whether or not it is participating in the transaction account guarantee. If it is participating, it must also disclose that funds held in non-interest bearing transaction accounts are fully FDIC-insured. The Final Rule requires that that the language be "simple" and "readily understandable," and provides suggested language. If the institution uses sweep arrangements or takes other actions that result in funds being transferred or reclassified to an account that is not guaranteed under the program, the institution must disclose those actions to affected customers and clearly advise them, in writing, that such actions will void the FDIC's guarantee with respect to such funds.

FDIC Oversight and Enforcement

All institutions that participate in the TLG Program will be subject to oversight by the FDIC for compliance with the terms of the TLG Program. By participating, they agree to be subject to the FDIC's authority to request information and conduct on-site reviews to verify such compliance. The FDIC has described this oversight as "normal" and designed to "prevent rapid growth and excessive risk taking". Participation in the TLG Program does not result in a change in any participating institution's primary federal banking regulator. The FDIC will consult with an institution's primary federal banking regulator in enforcing the provisions of the TLG Program as set forth in the Final Rule. Any party that becomes an eligible entity in a designation by the FDIC also becomes a participating institution in the TLG Program, which includes being subject to FDIC oversight.

For institutions participating in the debt guarantee, the FDIC may consider a payment default an unsafe or unsound practice, and such a determination could result in an enforcement action under the Federal Deposit Insurance Act. Furthermore, the Final Rule provides that, with respect to insured depository institutions, conditions giving rise to the FDIC's obligation to pay on its guarantee are a sufficient basis for the FDIC to appoint itself as conservator or

receiver of such an institution. The Master Agreement clarifies that the FDIC has the ability to take enforcement actions against institutions for breach of the Master Agreement, false or misleading statements in connection with the institution's participation in the debt guarantee or bad-faith statements made with the intent to influence the actions of the FDIC. Such actions may include the termination of participation in the debt guarantee. Any such termination would be prospective only, and therefore any guaranteed debt outstanding at the time of the action would remain guaranteed.

References

Below are hyperlinks to selected FDIC releases related to the TLG Program.

- Final Rule
- Master Agreement
- FDIC Press Release
- Sample Election (Opt-In/Opt-Out) Form and Instructions

We will continue to monitor developments and issue additional newsflashes and memoranda as appropriate.

This is a summary that we believe may be of interest to you for general information. It is not a full analysis of the matters presented and should not be relied upon as legal advice.

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