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CLIENT ALERT

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Holding Company Participation in FDIC Guarantee Program

By: Peter G. Weinstock and Zonnie P. Breckinridge[1]

The FDIC altered significantly the specifications for holding company participation in the Temporary Liquidity Guarantee Program. The main impetus for the change was the strong support the Federal Reserve Board gave to expanding the FDIC guarantee of holding company leverage as a means to increase bank liquidity.

Eligibility and Opting Out

In addition to their subsidiary depository institutions, U.S. bank and thrift holding companies (other than "unitary thrift holding companies that are engaged in nonconfidential activities") are eligible to take advantage of the debt guarantee program. Certain affiliates of depository institutions may also be eligible as determined by the FDIC on a case-by-case basis.

Each eligible entity (both depository institutions and their parent companies) must inform the FDIC by December 5, 2008, if it desires to opt out of the program. The choice to opt out, once made, is irrevocable. Failure to opt out by 11:59 p.m., Eastern Standard Time, on December 5, 2008, will constitute a decision to remain in the program. Each eligible entity that wishes to participate in the Debt Guarantee Program must complete the election form available on the subsidiary bank's FDIC*connect* e-secure website, provide the amount of the entity's outstanding indebtedness as of September 30, 2008 (even if that amount was 0) and file the form via FDIC*connect* by December 5, 2008. All affiliated entities that are eligible to participate must make the same election.

Nature of Guaranteed Debt

The FDIC will guarantee "newly issued senior unsecured debt" that:

- is issued on or after October 14, 2008, and before July 1, 2009;
- is evidenced by a written agreement or trade confirmation;
- has a specified and fixed principal amount (thus, revolving credit arrangements would not be included);
- is not contingent and contains no embedded options, swaps or other derivative elements;
- is not subordinate to any other indebtedness (accordingly, subordinated

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debentures would not be included); and

- after December 5, 2008, has a maturity of more than 30 days.

Senior unsecured debt includes federal funds purchased (with 30-day or greater maturities after December 5, 2008); promissory notes; commercial paper; unsubordinated unsecured notes, including zero-coupon bonds; U.S. dollar-denominated certificates of deposit owed to an insured depository institution, insured credit union or foreign bank; U.S. dollar-denominated deposits in an international banking facility of an insured depository institution or a foreign bank; and U.S. dollar-denominated deposits on the books of foreign branches of U.S.-insured depository institutions, which are owed to an insured depository institution or a foreign bank.

Senior unsecured debt may pay a fixed or floating rate as long as it has a "commonly-used reference rate." Such a reference rate would include a single index, such as a Treasury bill rate, the prime rate or LIBOR.

Disqualification of Senior Unsecured Debt

Senior unsecured indebtedness will not be guaranteed by the FDIC if:

- the proceeds are used to prepay non-FDIC guaranteed debt,
- the holding company has opted out of the debt guarantee program (with some exceptions),
- the FDIC terminates the institution's participation,
- the indebtedness is owed to an affiliate,
- the holding company has exceeded its debt guarantee limit, or
- the debt does not otherwise meet the requirements of the rule.

Debt-Guarantee Limit

The FDIC will guarantee an amount of debt issued by an entity on or after October 14, 2008, based on the outstanding indebtedness of the entity as of September 30, 2008. For entities that had indebtedness outstanding on September 30, 2008, the maximum amount of newly issued senior unsecured debt that the FDIC will guarantee is up to 125 percent of the outstanding senior unsecured indebtedness that was outstanding on September 30 and that was scheduled to mature on or before June 30, 2009. The majority of banks and holding companies had no unsecured indebtedness outstanding on September 30 that was maturing by June 30, 2009 (other than Fed funds and trade payables). As a result, the final rule provides that participating depository institutions that had little or no indebtedness outstanding will have a guarantee limit equal to 2 percent of total liabilities as of September 30, 2008. Holding companies with little or no senior unsecured debt outstanding on September 30, 2008 that wish to participate must apply to have some amount of indebtedness covered by the program. The FDIC will evaluate requests for such guarantees on a case-by-case basis, after consultation with the appropriate federal banking agency.

All requests for establishing the debt guarantee limit must be made by letter application to the Director, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 10429, with a copy to the entity's supervising Federal Reserve Bank or the Office of Thrift Supervision. The letter application must describe the details of the request, provide a summary of the applicant's strategic operating plan and describe the proposed use of the debt proceeds.

In determining the amount of the guarantee, the FDIC will consider the financial condition and supervisory history of the proposed borrower, the strength from a ratings perspective of the issuer of the obligation that will be guaranteed, and the size and extent of the activities of the organization. The FDIC may consider any other factors that it deems relevant. The FDIC may make exceptions to an entity's debt guarantee limit or impose other requirements on the entity after consultation with the entity's primary federal banking regulator.

If an entity becomes a holding company after October 13, 2008, the entity must apply to have the amount of debt guarantee limit established in the same way as existing holding companies that had no debt outstanding as of September 30, 2008.

The debt guarantee limit of a surviving entity in a merger takes the debt guarantee limits of the merging entities, calculated on a pro forma basis, as of the close of business on September 30, 2008, unless the FDIC determines otherwise. Thus, institutions involved in a merger will need to consult with the FDIC.

An insured depository institution can, with prior written notice to and no objection from the FDIC, increase its own senior unsecured indebtedness that is guaranteed by using part of its parent's limit. In the event an insured depository institution were to do so, however, the debt guarantee limit of the holding company would be reduced by the amount of guaranteed debt that the subsidiary issued over its limit.

Master Agreement

In addition to any other condition imposed by the FDIC, a participating entity must consent to be bound by the terms and conditions of the program, by executing a master agreement with the FDIC. The form of that agreement is available on the FDIC's website.

Assessments

Participating entities will pay to the FDIC assessments equal to 50 basis points for debt with a maturity of 180 days or less, 75 basis points for debt with a maturity of between 181 and 364 days and 100 basis points for debt with a maturity that expires thereafter. The assessment will be determined by multiplying the amount of the guaranteed debt times the term of the debt (expressed in years) times the rate (annualized). There is an additional 10 basis-point charge if the assets of the insured depository institution are less than 50 percent of the holding company's consolidated assets as of September 30, 2008 (except for institutions that become eligible after October 13, 2008, in which case the date for this purpose will be the date of eligibility). The amount of the assessment is nonrefundable even if indebtedness is retired earlier than scheduled.

To avoid violations of the Bank Affiliates Act and Regulation W, the holding company must prepay the amount of its assessment to its subsidiary financial institution. The FDIC will draw its payment as an ACH debit from the insured depository institution's designated deposit account.

Duration of Guarantee

The FDIC's debt guarantee will generally expire at the earlier to occur of the maturity of the indebtedness or June 30, 2012.

Payment on the Guarantee

The FDIC's obligation to pay under the guarantee will arise upon a timely demand by the debtholder following a payment default. The FDIC will satisfy its guarantee by making scheduled payments of principal and interest pursuant to the terms of the debt instrument. The FDIC, in its discretion, may make a one-time payment at any time after June 30, 2012, as a final payment of principal and interest under a guaranteed instrument that has a maturity beyond that date. Upon payment of the guarantee, the FDIC will step into the shoes of the borrower and will be subrogated to the rights of each debtholder in a bankruptcy of the borrower.