August 26, 2009

MEMORANDUM TO: The Board of Directors

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SUBJECT: Final Rule Amending the Temporary Liquidity Guarantee Program to Extend the Transaction Account Guarantee Program with A Modified Fee Structure

I. SUMMARY OF RECOMMENDATION

Staff recommends that the Board adopt, and authorize publication in the *Federal Register* of, the attached Final Rule. The Final Rule amends various provisions in 12 C.F.R. Part 370 to: (1) extend for six months the expiration date of the Transaction Account Guarantee component (TAG program) of the Temporary Liquidity Guarantee Program (TLGP); (2) increase the assessment fee that applies during that six-month period from 10 basis points to either 15 basis points, 20 basis points, or 25 basis points depending on the Risk Category assigned to an entity in the FDIC's risk-based premium system; (3) provide a single opportunity for currently participating entities to opt out of the TAG program effective on January 1, 2010; and (4) provide a sample disclosure statement for those entities that elect to opt out.

II. BACKGROUND

In October 2008, the FDIC adopted the TLGP. The TLGP is part of a coordinated effort by the FDIC, the U.S. Department of the Treasury (Treasury), and the Board of Governors of Federal Reserve System to address unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and make loans to creditworthy borrowers.

The FDIC's TLGP was designed to be a temporary program and is comprised of two distinct components: (1) the Debt Guarantee Program (DGP), pursuant to which the FDIC guarantees certain senior unsecured debt issued by participating entities, and (2) the TAG program, pursuant to which the FDIC guarantees all funds held at participating insured depository institutions in qualifying noninterest-bearing transaction accounts above the existing deposit insurance limit. Over 7,100 insured depository institutions (IDIs) are participating in the TAG program, with an estimated $700 billion of deposits in noninterest-bearing transaction accounts currently subject to the FDIC's guarantee.

In order to provide an orderly phase-out of the TAG program for participating IDIs and their depositors, the FDIC issued a notice of proposed rulemaking (NPR) on June 23, 2009. The NPR presented two alternatives for phasing out the TAG program, alternative A and alternative B. In general, under alternative A, the FDIC would allow the TAG program to expire on December 31, 2009, as provided in the existing regulation. Under alternative B, the FDIC proposed to extend the TAG program for six months, through June 30, 2010, with certain modifications including increased fees for participation and conforming disclosure requirements (if necessary).

The NPR also requested comment on every aspect of the NPR, including whether alternative A or alternative B (or some other alternative) is preferred, and posed a series of questions related to specific areas of the proposal. Those questions include: whether six months is an appropriate extension for the TAG program; whether the proposed increase in the participation fee for the TAG program extension to 25 basis points is appropriate; and whether the FDIC should reduce the maximum interest rate for NOW accounts that qualify for the FDIC's guarantee under the TAG program to 0.25 percent.

The FDIC received 91 comments on the NPR. The commenters included 60 IDIs, 13 industry associations, 5 holding companies, 7 state government entities, 3 bankers' banks, and 3 depositors. The FDIC received 15 comments expressly favoring alternative A and 44 comments expressly favoring alternative B as written. An additional 28 commenters favored an extension of at least six months, but did not expressly endorse alternative B. Consequently, a majority of the comments received by the FDIC (72) favored extending the TAG program for at least six months, with 45 commenters (including some of the 44 who expressly favored alternative B) recommending that the FDIC extend the TAG program one year, through December 31, 2010.

The FDIC also received 20 comments recommending that the FDIC maintain the current fee structure (10 basis points) for participation in the TAG program through the extension period. A number of commenters (38) suggested that the FDIC adopt a fee that is less than 25 basis points but commensurate with the costs of the TAG program extension. Additionally, 23 commenters recommended that the FDIC adopt a risk-based approach for charging participants in the TAG program extension.

For the proposed reduction in the NOW account maximum interest rate, the FDIC received 28 comments with 12 supporting a reduction and 16 favoring no change.

III. THE FINAL RULE

Staff recommends that the Board adopt the Final Rule to extend the TAG program through June 30, 2010. Significant improvement in the financial markets has been made since last fall. However, there are still significant portions of the banking industry, particularly in regions still suffering the most from recent economic turmoil, that may need the benefits of the TAG program beyond the end of this year. Staff believes that a six-month extension of the TAG program will provide the optimum balance between continuing to provide support to those institutions and phasing out the program in an orderly manner.

Under the Final Rule, each participating entity will have an opportunity to opt out of the extension. The opportunity to opt out is a one-time option, and any decision to opt out is irrevocable. In order to exercise the option to opt out, a participating entity must submit an email to the FDIC no later than November 2, 2009 that meets all of the requirements of 12 C.F.R. § 370.5(g)(2).

Additionally, the final rule will impose a risk-based fee system and will increase the fees in relation to the current fee (from an annualized 10 basis points to an annualized minimum of 15 basis points) on those entities participating in the extension of the TAG program. Switching to a risk-based fee system will allow the FDIC to align the fees charged under the TAG program to the risks posed by institutions that participate, and the higher overall fees will better cover the potential costs of the program.

Beginning on January 1, 2010, a participating entity that does not opt out of the transaction account guarantee program in accordance with § 370.5(c)(2) will be required to pay quarterly an annualized fee in accordance with its respective Risk Category rating.

All institutions participating in the extended TAG program that are assigned to Risk Category I of the risk-based premium system will be charged an annualized fee of 15 basis points on their deposits in noninterest-bearing transactions accounts for the portion of the quarter in which they are assigned to Risk Category I. Institutions in Risk Category II will be charged an annualized fee of 20 basis points on deposits in noninterest-bearing transaction accounts for the portion of the quarter in which they are assigned to Risk Category II. Institutions in either Risk Category III or Risk Category IV will be charged an annualized fee of 25 basis points on deposits in noninterest-bearing transaction accounts for the portion of the quarter in which they are assigned to either Risk Category III or Risk Category IV.

The fee will apply to any deposit amounts exceeding the existing deposit insurance limit of $250,000, as reported on the quarterly Call Report in any noninterest-bearing transaction accounts (as defined in § 370.2(h)), including any such amounts swept from a noninterest bearing transaction account into an noninterest bearing savings deposit account as provided in § 370.4(c). The fee will continue to be collected quarterly in the same manner as provided for in existing regulations.

The Final Rule will not change the maximum interest rate limit for NOW accounts in order to avoid potential depositor confusion and prevent the need for participating institutions to revise or adjust their banking systems, customer agreements, and disclosures for the relatively short period of time of the extension (i.e., six months).

For purposes of the TAG program, the term "noninterest-bearing transaction account" will continue to include only those NOW accounts with interest rates no higher than 0.50 per cent as further described in 12 C.F.R. § 370.2(h).

IV. CONCLUSION

Staff recommends that the Board adopt the attached Final Rule and authorize its publication in the Federal Register.