[6714-01-P]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 370

RIN 3064-AD37

Modification of Temporary Liquidity Guarantee Program

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: **Final Rule.**

SUMMARY: The FDIC is issuing this Final Rule to make permanent a minor modification to the Temporary Liquidity Guarantee Program (TLGP) to include certain issuances of mandatory convertible debt (MCD) under the TLGP debt guarantee program (DGP).

DATES: The Final Rule becomes effective on [INSERT DATE THAT THE FINAL RULE IS PUBLISHED IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

Steven Burton, Senior Financial Analyst, Bank and Regulatory Policy Section, Division of Insurance and Research, (202) 898-3539 or sburton@fdic.gov; Robert C. Fick, Counsel, Legal Division, (202) 898-8962 or rfick@fdic.gov; A. Ann Johnson, Counsel, Legal Division (202) 898- 3573 or aajohnson@fdic.gov; Mark L. Handzlik, Senior Attorney, Legal Division, (202) 898-3990 or mhandzlik@fdic.gov; Gail Patelunas,

Deputy Director, Division of Resolutions and Receiverships, (202) 898-6779 or gpatelunas@fdic.gov; (*for questions or comments related to MCD applications*): Lisa D Arquette, Associate Director, Division of Supervision and Consumer Protection, (202) 898-8633 or larquette@fdic.gov; or Donna Saulnier, Manager, Assessment Policy Section, Division of Finance, (703) 562-6167 or dsaulnier@fdic.gov.

SUPPLEMENTARY INFORMATION

I. Background

On October 23, 2008 the FDIC's Board of Directors (Board) adopted the TLGP as part of a coordinated effort by the FDIC, the U.S. Department of the Treasury (Treasury), and the Board of Governors of the Federal Reserve System (Federal Reserve) to address unprecedented disruptions in credit markets and the resultant effects on the ability of financial institutions to fund themselves and make loans to creditworthy borrowers. The TLGP and other government programs have had favorable effects thus far; however the FDIC continues to evaluate ways to make the TLGP more effective.

On February 27, 2009 the Board adopted an Interim Rule that modified the then-existing DGP by extending the FDIC guarantee to certain new issues of MCD.[1] The purpose of the Interim Rule was to provide a mechanism for entities participating in the DGP to obtain funding from investors that may have a longer-term investment horizon. By providing a guarantee for senior unsecured debt that converts into common shares of the issuer, the FDIC expects the Interim Rule to moderate the potential funding needs that could result from concentrations of FDIC-guaranteed debt maturing in mid-2012.[2] The

[1] 74 FR 9522 (March 4, 2009).
[2] This modification of the TLGP is supported by the rationale for establishing the existing TLGP and is consistent with the determination of systemic risk made on October 14, 2008, pursuant to 12 U.S.C. section 1823(c)(4)(G), by the Secretary of the Treasury (after consultation with the President) following receipt of

FDIC solicited public comment on all aspects of the Interim Rule for a 15-day comment period.

On March 17, 2009, the Board adopted an interim rule entitled *Amendment Of The Temporary Liquidity Guarantee Program To Extend The Debt Guarantee Program And To Impose Surcharges On Assessments For Certain Debt Issued On Or After April 1, 2009*[3] (Extension Interim Rule), which further amended the DGP by, among other things, extending the duration of the DGP for certain participating entities, imposing surcharges on the issuance of certain FDIC-guaranteed debt, and providing for the issuance of non-guaranteed debt prior to the expiration of the DGP. On May 29, 2009 the Board adopted the Extension Interim Rule as a final rule without change. That final rule (Extension Final Rule) is being published simultaneously today elsewhere in the *Federal Register*.

II. The Interim Rule

The Interim Rule amended section 370.2(e)(5) to permit entities participating in the DGP to issue certain MCD upon application to and approval from the FDIC. The Interim Rule did not affect an entity's existing debt guarantee limit.

As provided in section 370.2(e) of the Interim Rule, FDIC-guaranteed MCD must be newly issued on or after February 27, 2009 and provide, in the debt instrument, for the mandatory conversion of the debt into common shares of the issuing entity on a specified date (unless the issuing entity fails to timely make any payment required under the debt instrument, or merges or consolidates with any other entity and is not the surviving or

---

the written recommendation dated October 13, 2008, of the FDIC's Board of Directors (Board) and the similar written recommendation of the Federal Reserve.

[3] 74 FR 12078 (March 23, 2009).

resulting entity). The Interim Rule also required an entity issuing MCD to provide certain disclosures to investors.

As indicated in the Interim Rule, a participating entity must file a written application with the FDIC and its appropriate Federal banking agency, and obtain the FDIC's prior written approval, before issuing MCD. Like other applications required for purposes of the DGP, an entity seeking to issue MCD must include the details of the request, a summary of the applicant's strategic operating plan, and a description of the proposed use of the debt proceeds. The application also must provide the proposed date of issuance, the amount of MCD to be issued, the mandatory conversion date, and the conversion rate (as described in Section 370.3(h)). Where the issuance of MCD could potentially raise control issues, the applicant must provide written confirmation that all applications and all notices required under the Bank Holding Company Act of 1956 (as amended), the Home Owners' Loan Act (as amended), or the Change in Bank Control Act (as amended) have been submitted to the appropriate Federal banking agency prior to issuing MCD.

Assessments for FDIC-guaranteed MCD are based on the time period from the issue date of the MCD until its mandatory conversion date.

III. Summary of Comments

The FDIC received eight comments on the Interim Rule from banking organizations, trade and industry groups, and certain individuals. The commenters generally supported the Interim Rule in that it would provide participating entities the flexibility needed to attract a broader group of investors, including those with longer-term investment horizons.

Several commenters encouraged the FDIC to revise the Interim Rule by making structural enhancements to MCD so that it would qualify for the Federal interest rate tax deduction, as provided under the Internal Revenue Code.[4] For example, the commenters suggested revising the Rule to provide for a mandatory unit structure, where remarketed debt proceeds are used to fund share purchases under a separate forward-purchase contract, and senior unsecured debt that converts to equity at the option of the investor. However, these structures contain certain features (such as the bundling of debt with a futures contract, the pledge of debt against the forward contract, possible contingencies related to debt remarketing efforts, and optionality pertaining to the conversion of debt to common shares of the issuer) that would make them ineligible for an FDIC guarantee.

Pursuant to the Interim Rule, the underlying debt instrument must, by its terms, provide for the conversion of the debt into the common shares of the issuing entity on a specified date. This modification of the DGP was intended to attract investors with longer-term investment horizons and reduce potential refinancing risks, and not to expand the definition of senior unsecured debt to include hybrid debt and equity securities with complex structures.

Some commenters encouraged the FDIC to coordinate with the Federal Reserve to permit MCD to qualify as Tier 1 capital. MCD issued under the DGP is not includable in the regulatory capital of a participating entity until such MCD converts to the common stock of such entity. The FDIC does not wish to consider or pursue exceptions to the existing regulatory capital framework for purposes of the TLGP. Notwithstanding the regulatory capital treatment for MCD, however, the FDIC believes that FDIC-guaranteed MCD provides significant benefits to issuers and investors in that such debt can be

[4] See 26 USC 163.

expected to offer higher coupon rates than other senior unsecured debt issues without a mandatory conversion feature. Also, for participating entities, the ability to issue MCD should facilitate liquidity and capital planning to the extent the conversion feature offsets the need to obtain new financing upon the expiration of the FDIC's guarantee.

Several commenters sought clarification on the scope of the FDIC guarantee with respect to MCD, and urged the FDIC to confirm (i) that the guarantee would cover scheduled payments of principal and interest through maturity even in the event of a bankruptcy, conservatorship, or receivership, and (ii) that investors would be made whole in the event they do not receive equity shares on the date of conversion.

The FDIC's obligation under the guarantee for MCD is basically the same as it is for any other FDIC-guaranteed debt. Generally, the FDIC will make scheduled payments of principal and interest pursuant to the terms of the debt instrument upon a "payment default" which is defined as the uncured failure of the issuing entity to make a timely payment of principal or interest required under the debt instrument. Therefore, it is irrelevant whether the payment default results from bankruptcy, conservatorship, receivership or some other event. The FDIC's guarantee protects investors when there has been a payment default whether or not there has been a bankruptcy, a conservatorship, or a receivership of the issuing entity.

The Interim Rule states that the FDIC will make scheduled payments of principal and interest "through maturity." Since MCD does not necessarily have a stated "maturity" date, the Final Rule makes clear that in the event of a payment default on MCD, the FDIC will make scheduled payments of principal and interest pursuant to the terms of the debt instrument *through the mandatory conversion date*.

With regard to the comment suggesting that the FDIC clarify that investors would be made whole in the event they do not receive equity shares on the date of conversion, the FDIC believes that the Interim Rule adequately describes the operation of the FDIC's guarantee obligation in the event of a payment default. Specifically, upon a payment default, the FDIC will make scheduled payments of principal and interest pursuant to the terms of the debt instrument *through the mandatory conversion date*. Failure to deliver shares on the conversion date would not necessarily constitute a "payment default." However, the FDIC anticipates that the debt instrument for MCD will require a payment of the unpaid principal on the conversion date in the event of a payment default. To the extent that the debt instrument provides that a principal payment is due on the conversion date in the event of a payment default, the FDIC would make that principal payment subject to the limitation that the principal payment cannot exceed the amount paid by holders of the MCD under the issuance. As a result, the Final Rule does not make any changes to the Interim Rule with respect to that issue.

The following example illustrates how the Final Rule would operate in the event of a payment default on FDIC-guaranteed MCD after the bankruptcy of the issuer. Assume that a bank holding company (with the prior approval of the FDIC) issues MCD in which the note provides for monthly payments of interest for each of the seventeen months after the issue date. Assume also that the note provides that upon the eighteenth month the principal amount of the note shall convert to the common stock of the issuer unless there is a payment default. Finally, assume that in the event of a payment default the note requires that the issuer pay the debt holder the unpaid principal on the conversion date. If a petition in bankruptcy is filed against the issuer just prior to the twelfth month, but no payment default occurs until the fourteenth month, the FDIC would satisfy its guarantee obligation by making all payments of interest scheduled for months fourteen through seventeen. The FDIC also would pay to the holder of the note the unpaid principal amount, not to exceed the amount paid for the debt by the holder, on the conversion date (the eighteenth month).

One of the commenters also asked the FDIC to protect investors against losses resulting from government interventions short of placing issuing institutions into receivership. As described by the commenter, an example would include a situation where a federal agency directly acquired, or acquired the right to receive (through warrants or other convertible securities) more than one-third of the common stock of an entity that has received approval to issue MCD. Several commenters also asked the FDIC to consider expanding the guarantee to cover any amount of the original investment (of principal) that is not recovered upon conversion. The FDIC does not wish to extend its guarantee to cover situations that do not involve payment default by the issuer Such a change would protect investors against investment losses attributable to declines in the value of the convertible debt instrument, as opposed to losses related to an actual default on the underlying obligation.

Two commenters urged the FDIC to revise the Interim Rule by eliminating the prior application requirement for issuing MCD, thereby allowing participating entities to issue MCD at their own discretion. As provided in the Interim Rule and under the Final Rule, the FDIC will review applications to issue MCD on a case-by-case basis to ensure that the transaction will meet the requirements of the DGP, and confirm that all applicable applications and notices have been submitted to the appropriate Federal banking agency where the transaction could present a change in control issue.

Several commenters encouraged the FDIC to allow entities that issue MCD to use the proceeds of the issuance to replace other non-FDIC guaranteed debt and other regulatory capital instruments, such as Capital Purchase Program (CPP) obligations. The FDIC does not believe it is appropriate to allow participating entities to use the proceeds of FDIC-guaranteed debt to prepay non-FDIC guaranteed obligations because such prepayments would be inconsistent with one of the primary objectives of the DGP, which is to encourage participating entities to lend to creditworthy borrowers.

One commenter urged the FDIC to revise the Interim Rule to permit subsidiaries of holding companies to issue MCD that, under the terms of the debt instrument, converts to the common stock of an affiliate. Such a provision would allow holding companies to effectively use the debt guarantee limit of an insured depository institution subsidiary for the holding company's own capital planning purposes. The FDIC is concerned that this type of funding arrangement could ultimately benefit the holding company at the expense of the insured depository institution subsidiary, where the depository institution could be forced to seek replacement funding once the debt converts to the common stock of the holding company. Accordingly, the FDIC will only approve applications to issue MCD that, by its terms, requires conversion of the debt into common stock of the issuing entity on a specified conversion date.

Commenters also sought additional flexibility in determining the debt guarantee limit for bank holding companies. Specifically, the commenters suggested revising the Interim Rule to permit a bank holding company to issue senior unsecured debt up to the amount that is permissible for an insured depository institution subsidiary, or provide a separate debt guarantee limit for bank holding companies based on a delineated percentage of liabilities or risk-weighted assets. Two other commenters encouraged the FDIC to modify the TLGP in a way that would permit eligible entities to use the TLGP for purposes of raising capital. One of these commenters suggested revising the definition of senior unsecured debt to include trust preferred securities and subordinated debentures.

Under the TLGP, debt guarantee limits are based on the liquidity needs of an entity as determined by senior unsecured debt outstanding on September 30, 2008 (or 2 percent of liabilities for insured depository institutions without any outstanding senior unsecured debt on September 30, 2008). Although the Interim Rule provides an opportunity to attract future capital in the form of common equity, the purpose of the TLGP is not to recapitalize the banking industry. The FDIC notes that capital deficiencies are being addressed by other government programs and initiatives, such as the Troubled Asset Relief Program (TARP) and the CPP.

Another commenter requested a second opportunity to opt-into the TLGP, in light of the modifications to the DGP provided under the Interim Rule. The FDIC notes that on March 17, 2009, the Board approved an Interim Rule that extends the DGP and imposes surcharges on assessments for certain debt issued on or after April 1, 2009 (the Extension Rule).[5] One of the purposes of the DGP extension is to ensure an orderly phase-out of the TLGP. Providing a second opportunity to opt-into the DGP would be contrary to that effort. Further, the FDIC believes the TLGP has provided reliable and cost-efficient liquidity support to financial institutions with demonstrated funding needs.

[5] See 74 FR 12078 (March 23, 2009).

Institutions that have elected to opt-out of the TLGP are less likely to have such funding needs and, therefore, the FDIC believes that providing a second opportunity to opt-into the DGP would be of marginal benefit to the industry.

Finally, one commenter suggested revising the DGP to permit mutual banking organizations to issue MCD, on the condition that such organizations would convert to stock form on or before the conversion date. According to the commenter, this would allow mutual banks to raise capital now while they convert to stock form. The FDIC notes that mutual banking organizations must obtain regulatory approval to convert to a stock form of ownership, and that FDIC-guaranteed MCD is not recognized as regulatory capital until the debt converts into common equity of the issuer. In addition, the purpose of the TLGP is not to create incentives that would promote one form of ownership structure over another.

Although the FDIC received a few other comments in connection with the Interim Rule, they were either unrelated to the substance of the Interim Rule or applicable to the Extension Rule approved by the Board on March 17, 2009, which provides for a limited, four-month extension of the DGP.[6]

IV. Final Rule

The Interim Rule generally permits entities participating in the DGP to issue FDIC-guaranteed MCD upon application to and approval from the FDIC. FDIC-guaranteed MCD must, in the debt instrument, provide for the mandatory conversion of the debt into the common equity of the issuer on a specified date, which must be on or before the expiration of the FDIC's guarantee.

---

[6] Id.

This Final Rule adopts the Interim Rule (as amended by the final rule entitled *Amendment Of The Temporary Liquidity Guarantee Program To Extend The Debt Guarantee Program And To Impose Surcharges On Assessments For Certain Debt Issued On Or After April 1, 2009* which was issued by the Board on May 29, 2009) with one change.[7] Because MCD does not have a maturity date as such, this Final Rule clarifies that, with respect to MCD, the FDIC guarantee covers scheduled payments of principal and interest through the date of conversion.

VI. Regulatory Analysis and Procedure

A. Administrative Procedure Act

The process of amending Part 370 by means of this Final Rule is governed by the Administrative Procedure Act (APA). Pursuant to Section 553(b)(B) of the APA, general notice and opportunity for public comment are not required with respect to a rule making when an agency for good cause finds that "notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Similarly, Section 553(d)(3) of the APA provides that an agency, for good cause found and published with the rule, does not have to comply with the requirement that a substantive rule be published not less than 30 days before its effective date. When it issued the Interim Rule, the FDIC invoked these good cause exceptions based on the unprecedented disruption of the credit markets that has occurred as a result of the severe financial conditions that threaten the nation's economy and the stability of the banking system. For this same reason, the FDIC invokes the good cause exceptions with respect to the Final Rule.

B. Riegle Community Development and Regulatory Improvement Act

[7] See SUPPLEMENTARY INFORMATION, Section I. Background.

The Riegle Community Development and Regulatory Improvement Act provides that any new regulations or amendments to regulations prescribed by a Federal banking agency that impose additional reporting, disclosures, or other new requirements on insured depository institutions shall take effect on the first day of the calendar quarter which begins on or after the date on which the regulations are published in final form, unless the agency determines, for good cause published with the rule, that the rule should become effective before such time.[8]

The FDIC invoked the good cause exception for purposes of the Interim Rule because of the unprecedented disruption of the credit markets that has occurred as a result of the severe financial conditions that threaten the nation's economy and the stability of the banking system. The FDIC had determined that any delay of the effective date for the Interim Rule would have had serious adverse effects on the economy and the stability of the financial system. For these same reasons, the FDIC invokes the good cause exception for purposes of the Final Rule.

C. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget (OMB) has previously determined that the Interim Rule is not a "major rule" within the meaning of the relevant sections of the Small Business Regulatory Enforcement Act of 1996 (SBREFA).[9] The OMB also has determined that this Final Rule is not a "major rule" within the meaning of the SBREFA.

D. Regulatory Flexibility Act

---

[8] 12 U.S.C. 4802.
[9] 5 U.S.C. § 801 *et seq.*

The Regulatory Flexibility Act (RFA)[10] requires an agency to prepare a final regulatory flexibility analysis when an agency promulgates a final rule under section 553 of the APA, after being required by that section to publish a notice of proposed rulemaking. Because the FDIC has invoked the good cause exception provided for in section 553(b)(B) of the APA, with respect to this Final Rule, the RFA's requirement to prepare a final regulatory analysis does not apply.

E. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995,[11] an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The Final Rule, as did the Interim Rule, includes in sections 370.3(h)(1)(v) and 370.3(h)(2) a requirement for submission of an application setting forth certain specific items of information for institutions seeking to issue FDIC-guaranteed MCD. On February 27, 2009, the FDIC requested and received approval under OMB's emergency clearance procedures to revise its existing collection of information entitled, "Temporary Liquidity Guarantee Program" (OMB Control No. 3064-0166), to incorporate the paperwork burden associated with applications to issue MCD.

The Interim Rule requested comments on the paperwork burden associated with applications to issue MCD, and only one such comment was received. The commenter suggested that in lieu of the extra paperwork burden created by the application requirement, the FDIC should allow institutions to issue MCD at their own discretion,

[10] Pub. L. 96-354, Sept. 19, 1980.
[11] 44 U.S.C. 3501 et seq.

limited only by their debt issuance caps. As noted in the *Summary of Comments* section of the preamble, the information submitted in applications allows the FDIC to ensure that proposed transactions will meet the requirements of the DGP and confirm that all applicable applications and notices have been submitted to the appropriate Federal banking agency in cases where the transaction could present a change in control issue. Accordingly, the FDIC declines to adopt that suggestion.

On March 11, 2009, the FDIC began the process for normal clearance of the Temporary Liquidity Guarantee Program information collection, including applications to issue MCD, with publication of an initial 60-day notice requesting comment on: (1) Whether this collection of information is necessary for the proper performance of the FDIC's functions, including whether the information has practical utility; (2) the accuracy of the estimates of the burden of the information collection, including the validity of the methodologies and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and (5) estimates of capital or start up costs, and costs of operation, maintenance and purchase of services to provide the information. The comment period ends on May 11, 2009. Interested parties are invited to submit written comments on the estimated burden for applications to issue MCD, or any other aspect of the Temporary Liquidity Guarantee Program information collection, by any of the following methods:

- *http://www.FDIC.gov/regulations/laws/federal/propose.html*.

- *E-mail:* comments@fdic.gov. Include the name and number of the collection in the subject line of the message.
- *Mail:* Leneta Gregorie (202-898-3719), Counsel, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.
- *Hand Delivery:* Comments may be hand-delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7 a.m. and 5 p.m.

A copy of the comment may also be submitted to the OMB Desk Officer for the FDIC, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503. All comments should refer to the name and number of the collection.

The burden estimate for the application to issue FDIC-guaranteed mandatory convertible debt is as follows:

Title: Temporary Liquidity Guarantee Program.

OMB Number: 3064-0166.

Frequency of Response: 5

Estimated Number of Respondents: 25

Average Time for Response: 1 hour

Estimated Annual Burden: 125 hours

Previous Annual Burden: 2,201,550 hours

Total New Burden: 2,201,675 hours

Accordingly, the Interim Rule amending 12 C.F.R. part 370 which was published at 74 FR 9522 on March 4, 2009 is adopted as a final rule with the following change:

List of Subjects in 12 CFR Part 370

Banks, Banking, Bank deposit insurance, Holding companies, National banks, Reporting and recordkeeping requirements, Savings associations.

PART 370—TEMPORARY LIQUIDITY GUARANTEE PROGRAM

1. The authority citation for part 370 shall continue to read as follows:

Authority: 12 U.S.C. 1813(l), 1813(m), 1817(i), 1818, 1819(a)(Tenth), 1820(f), 1821(a), 1821(c), 1821(d), 1823(c)(4).

2. In part 370, amend section 370.12 by revising paragraph (b)(2) as follows:

§ 370.12 Payment on the Guarantee.

(a) * * *

(b) Payments on Guaranteed Debt of participating entities in default.

(1) * * *

(2) Method of payment. Upon the occurrence of a payment default, the FDIC shall satisfy its guarantee obligation by making scheduled payments of principal and interest pursuant to the terms of the debt instrument through maturity, or in the case of mandatory convertible debt, through the mandatory conversion date (without regard to default or penalty provisions). Any principal payment on mandatory convertible debt shall be limited to amounts paid by holders under the issuance. The FDIC may in its discretion, at any time after the expiration of the guarantee period, elect to make a final payment of all outstanding principal and

interest due under a guaranteed debt instrument whose maturity extends beyond that date. In such case, the FDIC shall not be liable for any prepayment penalty.

* * * * *