AMERICAN BANKERS ASSOCIATION ®

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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Robert W. Strand
Senior Economist
202-663-5350
rstrand@aba.com

March 19, 2009

By electronic delivery

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Attention: Comments

Re: RIN 3064–AD37; Interim Rule on Modification of the Temporary Liquidity Guarantee Program; 12 CFR Part 370; 74 *Federal Register* 9522, March 4, 2009

Dear Mr. Feldman:

The American Bankers Association (ABA) welcomes the opportunity to comment on the interim rule from the Federal Deposit Insurance Corporation (FDIC) to modify the Temporary Liquidity Guarantee Program (TLGP). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $14 trillion in assets and employ over 2 million men and women.

Under the Debt Guarantee Program (DGP) of the TLGP, each participating institution is authorized to issue qualifying senior unsecured debt up to a set limit, and that debt is fully guaranteed by the FDIC. The interim rule extends the classes of qualifying debt to include newly-issued senior unsecured debt with a feature that mandates conversion into common shares no later than June 30, 2012. As proposed, no guaranteed mandatory convertible debt (MCD) may be issued without prior written approval from the FDIC.

The intent of the change is to give institutions participating in the DGP additional flexibility to obtain funding from investors with longer-term investment horizons. Further, MCD issuances reduce the concentration of FDIC-guaranteed debt maturing in mid-2012.

ABA makes the following recommendations for the interim rule:

- The FDIC should make clear that the guarantee on MCD is robust.
- The FDIC should coordinate with the Federal Reserve to enable guaranteed MCD to count as Tier 1 capital.
- The FDIC should permit guaranteed MCD to use the traditional "mandatory unit" structure.
- The MCD issuance provisions should be loosened.
- Issuance limits under the Debt Guarantee Program should be made fairer.
- Institutions should have a second chance to opt into the Debt Guarantee Program.
- The Debt Guarantee Program should be further extended to include collateralized debt.
- Participating institutions should be permitted to issue guaranteed MCD with conversion mandated as late as the end of 2012 immediately.

These recommendations are discussed in detail below.

I. Extension of the Debt Guarantee Program to include Mandatory Convertible Debt

ABA appreciates inclusion of MCD as part of the TLGP DGP. This revision can help banks and banking firms gain access to liquidity by allowing them to market an attractive debt security. Perhaps more important, private investors will appreciate MCD issued under the DGP because of the FDIC guarantee and because of the eventual boost to capital for issuing institutions, again increasing institutions' access to liquidity.

The FDIC has stated that it "believes that the TLGP promotes financial stability by preserving confidence in the banking system and encouraging liquidity in order to ease lending to creditworthy businesses and consumers."[1] We agree and suggest further that the support for banks' and banking firms' ability to raise private capital will, in turn, be a meaningful step to building equity investor support going forward by demonstrating banks' renewed ability to raise capital. This is a critical step towards strengthening the banking sector.

The added benefit is that building bank capital will spur lending to creditworthy borrowers and ultimately translate into economic growth. A healthier economy will mean a healthier banking system, and *vice versa*. Getting private investor support for banking firms is critical to achieving long term economic growth.

Bankers have noted that federal attempts to date to inject capital into banks through the Troubled Asset Relief Program's Capital Purchase Program (CPP), while well intentioned, have created an overhang in bank equities driven by fears of the conditions of the program. This has hindered banks' ability to raise capital from private sources. The MCD addition to the DGP is therefore needed.

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[1] FDIC, "Temporary Liquidity Guarantee Program," 73 *Federal Register* 72244, November 26, 2008.

➢ The FDIC should make clear that the guarantee on MCD is robust.

ABA fully appreciates that, in finalizing the original TLGP rule, the FDIC heeded industry advice to clarify the form of the TLGP guarantee for eligible debt securities. Similarly, bankers advise that the rules for guaranteed MCD securities should be augmented to clarify for investors the robustness of the guarantee.

For debt investors, the final rule should be made clear that:

- the FDIC would, upon failure of an issuer to make a scheduled principal or interest payment, satisfy its guarantee by making scheduled payments of principal and interest pursuant to the terms of the security through maturity, regardless of the conversion provisions; and
- the terms of guaranteed MCD securities can provide that, under circumstances in which the investors do not receive equity shares upon conversion, they will be made whole as to their original principal investment.

The interim rule permits non-conversion on guaranteed MCD upon (1) failure to make any interest or principal payment, or (2) certain merger or consolidation arrangements. Such events, however, may not be the most material risks from an equity investor's perspective. Seeing how some troubled financial institutions have been handled recently, investors seek protection against not just actual failures, but *de facto* failures as well. Accordingly, the final rule should specify that a federal non-bankruptcy conservatorship would yield the same treatment for unconverted MCD as full, legal bankruptcy. The fear is that, should an issuer be placed into conservatorship (like Freddie Mac and Fannie Mae) without elimination of the common equity, conversion at maturity would leave the investors with near total loss. Similarly, investors seek protection in the case of federal investment. The regulations should provide protection for investors prior to conversion in the event that a federal agency acquires, or acquires the right to receive (through warrants or conversion), any more than one-third of the common stock of the issuer.

➢ The FDIC should coordinate with the Federal Reserve to enable guaranteed MCD to count as Tier 1 capital.

A most important point is that the FDIC should coordinate with the Federal Reserve as to the qualifications for MCD securities issued under the DGP to count as Tier 1 capital. This level of coordination was provided for capital issued under the CPP, and it would be appropriate in this case as well. Such coordination would encourage banks and banking firms to utilize this product as a substitute for senior debt.

Additionally, we encourage the FDIC to discuss with the Federal Reserve treatment of FDIC-guaranteed MCD as *unrestricted* Tier 1 capital. This is important because many institutions have exhausted their capacity for restricted Tier 1 instruments. Designation as *unrestricted* Tier 1 capital is supported by the nature of these securities and their ultimate conversion into common equity in 3-to-3½ years. For MCD to achieve Tier 1 capital status, the Federal Reserve generally requires that the security convert into common equity in the event that, among other things, the issuer ceases to be "well capitalized." To support an *unrestricted* Tier 1 capital designation, we suggest that the final rule should permit guaranteed MCD with forced conversion to common equity under such circumstances.

➢ The FDIC should permit guaranteed MCD to use the traditional "mandatory unit" structure.

The FDIC may wish to consider permitting guaranteed MCD securities to be created using the traditional "mandatory unit" structure, rather than as single convertible debt instruments. Under the unit structure, the security sold to investors is typically comprised of:

- a $1,000 piece of debt (typically with a five-year final maturity), and
- a forward purchase contract under which the investor is obligated to pay $1,000 to the issuer in three years to purchase a specified number of common shares (typically at a level at or above the prevailing market price, depending on the stock price in three years).

We expect that the debt component of the security would be guaranteed only until June 30, 2012 (or December 31, 2012, as newly proposed). After that, the interest rate on the debt component of the security is reset and the security is "remarketed" to new investors; the proceeds of this remarketing are paid to the original investors who use it to purchase shares under the purchase contract.

The unit structure has several advantages. First, unlike a single debt security that mandatorily converts into common stock, the debt component of a mandatory unit structure is generally tax deductible, which provides an economic benefit to issuers. Second, rating agencies and investors are familiar with the unit structure. Third, separation of the debt component from the equity component may simplify some of the structural elements of the security. For example, the debt component could be non-convertible senior debt with a structure that is already permissible under the DGP. And fourth, a Federal Reserve requirement that the security automatically converts in the event of certain stress triggers may also be simpler to accomplish in a unit structure. While a unitary mandatory convertible debt structure may, in fact, require a "put right" from investors to the government, a unit structure could simply have the forward contract with the issuers terminate (as described above) and be replaced by a contract between the issuer and the government; no direct investor-regulator contact is required.

➢ The MCD issuance provisions should be loosened.

The interim rule states that "no FDIC-guaranteed MCD may be issued without the FDIC's prior written approval" and further requires that eligible entities must submit a "strategic operating plan" and a description of the "use of the debt proceeds" (page 9522). We feel that allowing participating institutions to issue MCD at their own discretion would provide more clarity and comfort for investors as to the banks' ability to raise private capital. In electing to issue as convertible, instead of non-convertible, securities, an institution should be limited by its issuance cap, not by an extra paperwork burden. In fact, since MCD must convert to common equity, this should provide good reason for the FDIC to avoid red tape.

At the least, bankers would appreciate more guidance on satisfactory uses of funds raised through guaranteed MCD issuance. For example, would it be acceptable for the funds to be used to repay CPP obligations? We ask that institutions be permitted to replace existing preferred, trust preferred, and other debt with MCD, ultimately raising tangible common equity (TCE) instead of debt.

II. Other Elements of the TLGP Debt Guarantee Program

Some issues not considered in the interim rule warrant comment here, including DGP issuance limits, opting into the program, and inclusion of secured debt.

- Issuance limits under the Debt Guarantee Program should be made fairer.

The interim rule would not alter participating institutions' existing guaranteed debt issuance limits. While we understand the intent to contain the FDIC's aggregate exposure, we believe that this policy carries on significant inequities between issuers. Institutions that had a lot of senior unsecured debt outstanding last September, in many cases by coincidence, will continue to be advantaged through the DGP. On the other hand, issuers that held limited or no senior unsecured debt last September will not be able to raise liquidity or capital to the same degree, putting them at a competitive disadvantage in extending new loans and offering other business.

The TLGP rule allows institutions that had no senior unsecured debt outstanding last September 30, and therefore had no capacity under the DGP, to apply to the FDIC for a positive guaranteed debt cap. In theory, this provision could have provided for more fairness in the program. In practice, however, we have heard from many institutions that submitted applications but were either denied or else invited to withdraw their applications. At this point, a more equitable solution is in order.

The original intent of the TLGP was to support bank liquidity. Capacity was allocated based on institutions' liquidity needs, as demonstrated by their balance sheets. Because the link between liquidity and capital needs is weak, we believe that the FDIC should establish capacity to issue MCD based on a measure that ensures equal opportunity for institutions to raise capital.

One approach would be to provide capacity of up to two percent of total liabilities for holding companies – not just banks – or alternately three percent of risk-weighted assets (consistent with the CPP). Moreover, banks should be allowed to utilize their existing capacity by transferring it to the holding company, or else issue MCD that converts to equity at the holding company level.

We note that a second interim rule on the DGP, issued on March 17, would require institutions that opted into the program but have not issued guaranteed debt by the end of this month to reapply for participation. We believe that this change will free up some room in the FDIC's aggregate debt limit and allow for some more capacity for institutions that have no or very limited caps.

- Institutions should have a second chance to opt into the Debt Guarantee Program.

The FDIC must acknowledge that addition of MCD, as well as the just-announced four-month extension of the DGP, make the program more attractive than when bankers had to choose whether to opt in or out last December 12. Moreover, as Chairman Bair noted on March 17, tightness in the debt markets has not been resolved at this point as many expected then. At this point, it is likely that many banks and banking firms would appreciate a second chance to opt into the program. Again, it is a matter of equity and maintaining competitive balance within the industry.

- The Debt Guarantee Program should be further extended to include collateralized debt.

Chairman Bair has mentioned extending the DGP to include collateralized debt. Moreover, we note that the more recent TLGP interim rule provides that a "non-insured depository institution" may be required to pledge collateral to issue under the proposed program extension. We believe that adding secured securities – with suitable qualifications – to the list of securities that can be guaranteed under the DGP is worth considering. Like a line of credit or other debt enhancement on secured debt, an FDIC guarantee would make such debt more attractive to the market and therefore promote bank liquidity – the point of the TLGP. Certainly, we would expect lower guarantee fees for secured debt, commensurate with the lower risk. No change in issuance limits would be required for this change, so it would not affect FDIC exposure.

- Participating institutions should immediately be permitted to issue guaranteed MCD with conversion mandated as late as the end of 2012.

The second DGP interim rule released on March 17 would extend the time through which guaranteed debt is guaranteed, or before which MCD must convert, to December 31, 2012 (from June 30, 2012). However, the added time applies only to debt issued after April 1, 2009. We feel that the added flexibility is a positive development, as we intend to comment on that interim rule. However, there is no clear reason to delay implementation. With little time left in the program and continuing tightness in the debt markets, there is every reason to put the change into effect immediately.

III. Conclusion

ABA appreciates this opportunity to comment on the interim rule. The TLGP has significantly helped assure that sound banks and banking firms can find liquidity, and this has supported their continued lending. We are prepared to work with the FDIC staff on this and other proposed amendments to the program.

Sincerely,

Robert W. Strand