

*Information as of 10/19/08*

***FDIC Temporary Liquidity Guarantee Program***  
***What is It and***  
***What Does It Mean to Community Banks?***



# Introduction – The Liquidity Guarantee Program

- ◆ The FDIC has created a temporary liquidity guarantee program in an effort to strengthen confidence in depositors, lenders and other investors and foster liquidity in banks and thrifts. The program has two components:
  - FDIC guarantee of newly issued senior unsecured debt
  - Unlimited FDIC deposit insurance on non-interest bearing deposit transaction accounts
- ◆ The guarantee of newly issued unsecured debt is intended to restore day to day *short-term lending between banks* by assuring lending banks that the FDIC will pay if the borrowing bank becomes insolvent, on a basis no different than if the borrowing was an [unsecured or insured] deposit
- ◆ The guarantee program also facilitates the ability of banks and BHCs to *incur new debt from institutional and other investors* [in which new debt matures in not more than three years], again by assuring [investors] that the FDIC will pay if the bank becomes insolvent. This should permit banks to:
  - Repay and prepay debt presently on their balance sheet which matures between now and 2012, which the banks might not have been able to prepay or repay without impairing liquidity
  - Refinance more expensive debt maturing within 3 years with debt issued between now and June 30, 2009 which may be less expensive by reason of the FDIC guarantee
  - Incur longer term senior unsecured debt today, (the cost of which over the next 3 years will reflect the presence of the guarantee) the proceeds of which can be used for *any purpose* including providing funds to grow the bank
  - If debt is incurred at the BHC level, permits the BHC to push down the proceeds to the bank as Tier 1 equity capital. [Capital is not tested on a consolidated basis for BHCs under \$500 million and therefore this Tier 1 capital at the bank level is not eliminated in consolidation]

# Introduction – The Liquidity Guarantee Program

- ◆ The FDIC also will insure through the end of next year deposits in non-interest bearing accounts by removing the \$250,000 insurance limit on them
- ◆ To guard against “excessive risk taking” and “excessive leverage” the FDIC and the bank’s primary regulatory will provide additional oversight. The FDIC does not define the terms “excessive leverage” or “excessive risk”
- ◆ The terms of the program are as follows:

# Senior unsecured debt guarantee: Term sheet

## Participation:

- ◆ Mandatory participation for the duration for both of the guaranteed loan program *and* the deposit guarantee program, if the institution does not “Opt-out” within 30-days
  - *There are four potential opt outs – one for each program so that you can opt out of one, neither, or both, at each of the bank and BHC level*
  - *If an entity fails to opt out, the entity is in the program for the duration and will be subject to the payment of program premiums*
  - *“Opt-out” period runs from October 14, 2008. Participation in the program will be disclosed by FDIC on its website*

## Eligibility

- ◆ All FDIC insured institutions, Bank Holding Companies, Financial Holding Companies, and Savings & Loan Holding Companies
  - *SLHCs owned by commercial companies are excluded*
- ◆ FDIC maintains control over eligibility for the guarantee programs, in consultation with bank’s and/or BHC’s primary regulator. Eligibility guidelines will be posted on the FDIC website some time in the very near future

# Senior unsecured debt guarantee

## Guarantee:

- ◆ An amount equal to 125% of senior unsecured bank debt and 125% of senior unsecured BHC debt outstanding as of September 30, 2008 which is scheduled to mature before June 30, 2009. The guarantee implicitly kicks in when any institution fails or becomes insolvent
  - *Comment #1: The term “senior unsecured debt” is not defined, but seems to cover all debt for borrowed money, which is neither secured by a lien on a bank asset or presently “subordinated” by its terms to depositors or senior debt holders*
  - *Comment #2: Guarantee is self executing so that there will be no document appended to a debt instrument which is signed by the FDIC and states that it is a guarantee. Also the guarantee is probably not really a “guarantee” of the payment of principal and interest in the usual context. It is really in the nature of deposit insurance protection for the debt holder the same way deposit insurance protects a depositor if the institution becomes insolvent and subject to an FDIC resolution proceeding*
  - *Comment #3: If new debt is issued with a principal amount over the 125% guarantee limit the debt is [unsecured or not guaranteed]. LENDER BEWARE!!*
  - *Comment #4: The flexibility provided by the 25% cushion over the amount of existing senior unsecured debt will vary based on the [magnitude of the existing borrowers]. The more leverage the better*

## Premiums:

- ◆ 75 bps, per annum on the principal amount of all securities covered by the guarantee over the duration of the guarantee. No charge for the first 30 days

## Guarantee Term:

- ◆ Three years on new senior unsecured debt issued on or before June 30, 2009. Expiring June 30, 2012 regardless of remaining payments of principle and interest (maturity of guaranteed debt may exceed this date)
  - *Comment#1: The senior unsecured debt may mature at any time (e.g. in 10 years), but only the amount due during the covered 3 year period is guaranteed*

# Senior unsecured debt guarantee

## New Securities Covered by Guarantee:

- ◆ “Senior unsecured debt of bank” and BHC including promissory notes, commercial paper, interbank funding (Fed Funds)
  - *Comment #1: Guarantee will not cover secured debt, including repos; [will cover unsecured portion of repos]*
  - *Comment #2: Guarantee will not cover TRUPs; because the FDIC views them as equity. Hybrids are also not covered*
  - *Comment #3: Senior unsecured notes with warrants appear to be included, regardless of maturity*

## Limitations on Use of Proceeds:

- ◆ There is no limitation on the use of proceeds from new senior unsecured debt issued by bank or BHC

## Regulation

- ◆ FDIC has oversight with principal regulators to prevent rapid growth or excessive risk-taking
  - Excessive risk taking not defined

## Effective Date:

- ◆ Immediately

# Transaction account insurance

## Coverage:

- ◆ Unlimited coverage of Non-interest bearing transaction (demand) deposits accounts
  - *This will permit business to keep their pay rolls and other accounts at one bank*

## Cost:

- ◆ 10 basis point FDIC insurance surcharge on amounts in excess of the \$250,000 coverage limitation. No charge first 30 days

## Term:

- ◆ Coverage expires December 31, 2009

## Effective Date:

- ◆ Immediately

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