GETTING SQUASHED BY TLGP - INTERIM RULE

by Steve Brown

To make a good soup, you need to boil water, pour in some stock, add a dash of salt, a bit of pepper, garlic and some vegetables. But before we can sit down to slurp our soup today, we need to tackle the FDIC Temporary Liquidity Guarantee Program ("TLGP") and more specifically, the Debt Guarantee portion of that program (recall we covered the Transaction Account Guarantee yesterday and the MMIFF/CPFF on Mon.).

The Debt Guarantee Program ("DGP") is designed primarily to provide liquidity to the bank-to-bank lending market (inter-bank) and to help banks roll over unsecured debt. Fees for DGP are assessed at an annualized 75bp, based on total debt issued. DGP is in place now, covers issuance through Jun 30, 2009 (unless you opt out by Nov 12) and the guarantee lasts until Jun 30, 2012 (the maturity date of the debt can extend further, but it will not be guaranteed beyond this point). Put another way, debt issued before Oct 14 2008 or rolled over after Jun 30, 2009 is not covered. Debt that is retired early will not get a refund on the 75bp FDIC fee. For purposes of DGP, guaranteed debt includes Fed Funds purchased, promissory notes, commercial paper, unsubordinated unsecured notes, inter-bank CDs, bank deposits in an IBF and Eurodollar deposits. It does not cover, among other items, derivatives, derivative-linked products, debt paired with any other security, convertible debt, capital notes, negotiable CDs, obligations from guarantees of other contingent liabilities, debt paired with any other security and the unsecured portion of secured debt. DGP requires debt be evidenced by written agreement that contains a specific fixed principal amount to be paid on a certain date and indicate it is not subordinated to any other liability. DGP covers newly issued debt up to 125% of the par value of senior unsecured debt outstanding as of Sep 20, 2008 that is scheduled to mature before June 30, 2009. Banks that had little or nothing outstanding need to present a case to their primary regulator, who will decide with the FDIC on a case-bay-case basis. Banks that do not opt out are prohibited from issuing nonguaranteed debt until the maximum amount of guaranteed debt has been issued. In addition, banks that issue debt identified as "guaranteed by the FDIC" that is above the excess amount are subject to increased assessments totaling 150bp, enforcement actions and civil money penalties.

Our thoughts on the DGP: We expect community banks to think long and hard about this one, primarily because of the enormous cost of 75bp for the program. Every reader should email the FDIC and tell them the fee is too high relative to current market rates including Fed Funds. If the FOMC cuts the Fed Funds rate to 1% today (or even lower in coming months) and banks have to pay 75bp to the FDIC to be guaranteed, they could soon be underwater. It is critical that the program be reduced to a much lower flat rate (say 25bp) or indexed to the Fed Funds Target Rate so bankers don't get squeezed. Our other thoughts on DGP include: while it increases liquidity for those who participate, it could sharply reduce options for those banks who don't (it may result in lenders seeking out guaranteed banks and cutting Fed funds and other lines to unguaranteed banks); it is likely to be perceived as a strength by customers (with active marketing, this could lead to new opportunities for guaranteed banks to steal customers from unguaranteed banks); it will probably accelerate M&A activity (as unguaranteed banks lose customers and seek partners); the cost of term borrowing should be reduced since it tips toward risk-free (but after you include the fee it is debatable how much benefit you will actually receive); it expands opportunities to borrow at the holding company level (since that can also be guaranteed); and it does not directly impact current nonguaranteed funding options already in existence (such as FHLB or brokered CDs).

Assuming the FDIC modifies the 75bp fee and drops it to 25bp or indexes it to the Fed Funds Target Rate; we would expect the majority of community banks to participate. If the fee stays at 75bp, we would expect most community banks to opt out of this part of TLGP (but consider it closely) and lean instead on the noninterest bearing guarantee to capture customers.

Keep in mind as well, that as we said yesterday, all of the above is subject to change, since this all comes from the current FDIC "Interim Rule." To submit a comment, bankers can send an email to Comments@FDIC.gov and type "RIN # 3064-AD37" in the subject line of the message.

Tomorrow we will continue our discussion once again, as we serve up the TARP program.

BANK NEWS

TARP Capital

The Treasury released updated information saying that the current Capital Purchase Program was originally only targeted at publicly traded institutions. The Dept. is set to come out with a new set of Term Sheets AND deadlines (extending the current Nov. 14th date) for S Corps, Mutuals and thinly-traded institutions.

Credit Unions

A number of large credit unions are announcing 3Q losses, many for the 1st time. Those taking the brunt of losses are concentrated in areas suffering from sinking home prices and most impacted by the boom (CA, FL and AZ).