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The Temporary Liquidity Guarantee Program

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RESPONDING to the GLOBAL FINANCIAL CRISIS
What We Did and Why We Did It

The Temporary Liquidity Guarantee Program

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Note: The views expressed in this draft are strictly those of the author(s).

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Introduction

Although it cannot be considered in isolation from the other extraordinary steps taken by the government, and industry to address the destabilizing loss of confidence in the U.S. financial system during the fall of 2008, the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program (TLGP) played a critical role in returning liquidity to banks and their affiliates. The October 14, 2008 announcement of the TLGP along with the Troubled Asset Relief Program (TARP) and the Federal Reserve's Commercial Paper Funding Facility (CPFF), signaled a coordinated response that stemmed the deterioration of the financial system and laid a foundation for further efforts. By combining both a debt guarantee and a transaction account guarantee, the TLGP provided targeted support for the bank debt markets and deposit funding.

The context within which these governmental initiatives were developed and launched is a critical component to understanding the FDIC's key policy decisions and the lessons to be drawn from them for future crisis management.

By late September of 2008, the inter-bank markets in many financial assets were illiquid and, perhaps most critically, the ability of financial institutions to issue future debt was uncertain.[2] The financial system stood poised on the precipice of illiquidity and, if the markets froze, ultimately mass insolvency.[3]

The considerations of possible policy responses had to be accelerated by the imperative to design a reasoned plan that would work quickly and decisively to stem this free-fall in funding and market confidence. Policy-makers approached the challenges from their individual and institutional perspectives based on the information available to them. Though they recognized that capital responses alone were insufficient, how the illiquidity in the funding markets should be addressed was uncertain.

Policy-makers also are human. The stress of the prior months and the recurring crises occasionally led to misunderstandings and raised voices, but everyone placed a premium on focused professionalism and attention to the public good. Slip-ups were quickly addressed, and staff and policy-makers turned to the next issue.

While the debates were pointed at times, and there were recurring questions about the availability of information, in retrospect it is remarkable how quickly and effectively the interagency process worked and how well the public was served. The TLGP was proposed, developed, and implemented over only a few weeks in October and early November 2008.[4]

As described in greater detail below, the principal question faced by the FDIC was how to balance the imperatives imposed by its statutory mission with the recognized need to reverse the rapidly deteriorating liquidity stress faced by banks and broader financial sector. This question underlay all of the policy choices addressed by the FDIC

[2] FDIC, Overview XVI; Bernanke, pages 153-166; Bair, page 107.
[3] For a comparable judgment, see Bernanke, The Courage to Act at 336-37.
[4] The interactions are discussed in several post-crisis books, including Bair, Bernanke, Geithner, and Paulson.

during early October 2008 in creating the TLGP and in the agency's discussions with Treasury and the Federal Reserve. These choices continued to inform further elaboration of the program details leading up to the FDIC's adoption of the final rule on TLGP on November 21, 2008 as well as the subsequent developments in the TLGP. While any future crisis will have its own unique causes and trajectory, we believe that these policy debates and the balance ultimately drawn should be instructive for future policymakers.

I. How the TLGP Worked

The TLGP was composed of two distinct, but related, components. The Debt Guarantee Program (DGP) provided a limited-term guarantee for certain new debt issued by banks, thrifts, and financial holding companies and eligible subsidiaries. The Transaction Account Guarantee Program (TAGP) fully guaranteed specified non-interest bearing transaction deposit accounts held by insured depository institutions.[5]

Today the TLGP is recognized as a significant contributor to stabilization of liquidity for banking institutions. Of particular importance for future public policy, it was also one of the least controversial of the extraordinary measures adopted by the government during the crisis.[6] Perhaps former FDIC Chairman Sheila Bair best identified two of the key reasons for its acceptability in citing TLGP's industry funding and the comparatively limited scope of the program compared to some other crisis programs.[7]

Debt Guarantee Program (DGP)

The DGP guaranteed newly issued, senior unsecured debt by FDIC-insured depository institutions, their holding companies and other eligible financial institutions.[8] Bank and savings and loan holding companies were required to have at least one insured and operating depository institution, but the FDIC could make other affiliates eligible on a case-by-case basis after written request and with the agreement of the appropriate federal banking agency.

The DGP capped the debt guarantee at 125% of the par value of the senior unsecured debt to allow participants to roll over existing debt and allow for a modest growth of debt

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[5] FDIC, Crisis and Response: An FDIC History, 2008-2013 (2017) at 33. The authors are particularly grateful for the descriptions and analyses provided by the FDIC in this volume, and by the kind consultation provided by current and former FDIC staff members. We would particularly like to thank Art Murton, Diane Ellis, and Matt Green for their assistance. Any errors of fact or analysis are solely the responsibility of the authors.

[6] Hal Scott, *Connectedness and Contagion: Protecting the Financial System from Panics* (2016) at 75; Timothy Geithner, Stress Test: Reflections on Financial Crises (2014) at 231.

[7] Bair at 118.

[8] The DGP guarantee applied to *(i)* FDIC-insured depository institutions; *(ii)* U.S. bank holding companies; and (iii) U.S. savings and loan holding companies that either engaged only in activities permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act (BHCA) or had an insured depository institution subsidiary that was the subject of an application under Section 4(c)(8) of the BHCA regarding activities closely related to banking.

issuance. The Interim Rule provided that the payment of claims was to be triggered by the receivership for banks and bankruptcy for bank holding companies. Pricing under the Interim Rule was on an annualized flat-rate 75 basis points. As explained below, the Final Rule changed the trigger for the payment to an issuer's payment default. The FDIC also altered the flat-rate pricing approach to a sliding fee schedule ranging from 50 to 100 basis points.[9]

Transaction Account Guarantee Program (TAGP)

The TAGP extended deposit insurance coverage to all deposits in non-interest-bearing transaction accounts, as well as accounts that pay minimal interest. The goal of the TAGP was simply to stabilize deposit funding for banks by mitigating the risk that larger deposits would run and lead to further bank failures.

As was the case with the DGP, the TAGP received direct user fees. A surcharge of 10 basis points was applied to deposits in noninterest-bearing transaction accounts not otherwise covered by the existing deposit insurance limit of $250,000. The surcharge was added to the participating bank's risk-based deposit premium. The FDIC determined the continued eligibility requirements and parameters for use. With the extension of the program, fees were increased.

II. Confronting the Crisis: The Knowns and the Unknowns

The TLGP was a targeted response to the severe decline in market-based liquidity in August and September 2008. The growing loss of market liquidity was triggered by uncertainty over the extent of the impairment of mortgage-related assets and of the consequences for the balance sheets of banks, broker-dealers, and other financial institutions. This uncertainty was heightened by the shocks from the collapse of Lehman Brothers, the failure of Washington Mutual, and the threats to the stability of other even bigger financial institutions. The absence of clear information about the potential losses and where they might be incurred created suspicion that the scope and severity of the losses from mortgage-related assets, including mortgage-backed securities, and synthetic derivatives, was understated. This led market participants to deeply discount mortgage-related assets and financial institutions' balance sheets.

These issues had been building for an extended period. As credit intermediation moved progressively from banks to market-based mechanisms, investment firms, private equity, hedge funds, securities firms and others played increasingly vital roles in providing credit to consumer and businesses. This development had many positive features, such as greater access to credit, but it also meant that the limits placed on banks through leverage and funding controls had less impact on pricing and contractual terms than in previous credit cycles. Commercial paper conduits, structured investment vehicles, short-term repurchase agreements and other forms of securities-lending had become the mainstay of funding for key components of the financial system. While banks remained important sources for credit, they often found themselves chasing, rather than setting, pricing and

[9] FDIC at 45.

risk tolerance trends. With many of these activities occurring formally off the balance sheet of banks and other financial firms, the sources of information available to regulators were less illuminating about the real risks in the system.

As the crisis began to unfold in earnest in the fall of 2008, the regulators – particularly the FDIC—struggled to get accurate information about the risks to which banks were exposed, and the trajectory of the crisis. The exposures of individual institutions to structured investment vehicles are simply one illustration. Uncertainty about the depth of credit problems in residential mortgages combined with opacity in balance sheets and structured finance led to ever steeper discounts in asset values and in those companies holding mortgage-related assets.

When Lehman defaulted in September 2008, short-term investors learned that the Reserve Primary Fund, one of the largest US money market funds, was holding more than $785 million of Lehman's commercial paper. This recognition triggered a run on the fund which quickly spread across the money market industry. Although the Treasury was able to halt the contagion effects by announcing a guarantee for all money market funds, investors concluded that commercial paper was no longer safe. As a result, it was clear immediately following Lehman's default and the difficulties of AIG that banks relying to any appreciable degree on market-based funding would face increasing difficulty.

The decline in market-based funding was paralleled, though to a much lesser degree, by increasing volatility in deposit funding for some banks. The general uncertainty led to some significant withdrawals even from generally healthy banks. Bankers were particularly concerned about stability in deposit funding and the ability to retain small-business accounts exceeding the deposit insurance limits. While this issue had been addressed to some degree by the increase in insurance coverage to $250,000, the overall level of consumer and business uncertainty created concern that deposit volatility could engender additional stress on banks.

III. Developing the Framework: Sorting Out the Policy Issues

On October 14, 2008, the FDIC Board of Directors approved an interim final rule (the "Interim Rule") and on November 21 adopted a final rule (the "Final Rule") establishing the TLGP, as part of a coordinated effort by the FDIC, Treasury, and the Federal Reserve to address unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and to make loans to creditworthy borrowers.[10] On that same October day, the Secretary of the Treasury, Chairman of the FDIC, and Chairman of the Federal Reserve announced a package of governmental efforts designed to stem the loss of confidence in the financial system. The FDIC, Treasury, and the Federal Reserve hoped that the TLGP, along with other programs, including TARP and the CPFF, would promote financial stability.

[10] 73 Fed.Reg. 72244 (November 26, 2008). Before issuing the Final Rule, the FDIC issued the Interim Rule with request for comments which was published at 73 Fed.Reg. 64179 (October 29, 2008) and an Amendment to the Interim Rule which was published at 73 Fed.Reg 66160 (November 7, 2008).

The two weeks preceding the announcement were filled with dire news about the financial system, and intense debates over the government response. Even after October 14th, and as financial institutions began to issue FDIC-guaranteed debt, many of the operational details continued to be debated and refined. The program's final form was developed by the FDIC, where discussions were fueled by an interdisciplinary approach across the agency's supervisory, research, deposit insurance, consumer outreach and legal groups, and discussions with members of the Board. The TLGP was also was the product of interagency debate and of input from a variety of external sources—including bankers, rating agencies, advisory firms, and other market participants—about market conditions, necessary components, and likely market reactions.

When the TLGP was announced on October 14, 2008, all institutions that met the eligibility criteria, described in greater detail below, were automatically enrolled at no cost for 30 days. After that, eligible entities could opt out of either the DGP or TAGP, or both. The first FDIC-guaranteed debt was issued by eligible institutions on October 14th.11

It is important not to overlook the value added by analysis and advocacy from the unique perspectives of different statutory and regulatory authorities. The FDIC, in fact, has a different role and different responsibilities from the Treasury, the Federal Reserve or the Office of the Comptroller of the Currency. Those perspectives in combination usually yielded a superior result.

The U.S. actions did not occur in a vacuum. In Europe, the U.K. and other European countries had already put in place certain guarantees, and continued to explore additional options. U.S. regulators were conscious of the potential for U.S. banks to be placed at a competitive disadvantage if these varying government support actions appeared to provide foreign banks with clearer and more reliable support.

The DGP and the TAGP presented different policy questions.

Fundamentally, the policy issues surrounding the TAGP were much simpler since it involved an expansion of deposit guarantees embodied in the FDIC's historic mission. However, as discussed below, important considerations had to be addressed to ensure that the TAGP would be effective. Those principally illustrate the lesson that even long-standing and apparently well-understood government roles must be reconsidered in periods of severe stress to avoid unanticipated and unintended consequences. The TAGP was especially important for smaller banks, which expressed concerns that the DGP was designed to principally support the largest banks who relied much more on market-based funding.[12] Smaller banks believed they could be losing deposits, and the FDIC had

[11] See FDIC TLGP Debt Guarantee Program: Issuer Reported Debt Details, available at https://www.fdic.gov/regulations/resources/tlgp/totaldebt.pdf.

[12] See Final Rule Regarding Amendment of the Temporary Liquidity Guarantee Program To Extend the Transaction Account Guarantee Program (Federal Register, Vol. 75, No. 123, p. 36506, June 28, 2010) stating that "*The TAG component of the TLGP was developed, in part, to address concerns that a large number of account holders might withdraw their uninsured deposits from IDIs due to then prevailing economic uncertainties. Such withdrawals could have further destabilized financial markets and impaired the funding structure of smaller banks that rely on deposits as a primary source of funding* […]."

some evidence that deposits had been moving to larger banks. Some depositors had begun to act on the perception that larger banks were "too big to fail".[13]

The policy issues involved in development of the DGP were considerably more complex and ones with which the FDIC had comparatively little experience. However, in contrast to equity investments, the FDIC had long considered guarantees to be simpler to adopt and exit since there were not securities to purchase or sell, and to provide more leverage for the funds committed since actual payment was only required on default rather than at investment. Still, the FDIC's prior experience with guarantees of non-depository obligations of banks had all involved either open bank assistance transactions principally in the 1980s or closed bank resolutions involving bridge banks. No prior assistance transactions had involved guarantees of the magnitude contemplated by the DGP. Given the virtual collapse of the bank-related debt markets by early October 2008 and the interagency consensus that capital alone was insufficient, it was imperative to address the moribund debt markets. In effect, the conclusion was that the only prospect for doing this was to use the systemic risk exception to allow for a greatly expanded use of open bank assistance by the FDIC.

The key issues considered and addressed in the development of the DGP were the following:

1) Resolving questions about the FDIC's legal authority;
2) Deciding which entities would be eligible to participate, which inevitably included identifying the problem that realistically could be addressed;
3) Defining the types of debt that would be guaranteed
4) Formulating the contractual terms including when payment should be made on guaranteed debt, ratings requirements, reporting standards, and documentation needs; and
5) Pricing and other terms for the guarantee, which entailed balancing standards necessary to protect the DIF and achieve the goal of addressing the liquidity crisis.

This list is broadly inclusive of the principal issues considered and addressed, but it is not exhaustive. However, to provide a more focused consideration of the issues and the decisions that were made in resolving them, we have chosen these as key issues to illustrate the trade-offs necessary to implementation of a similar program in the future.

[13] For example, see Sheila Bair, Statement at the U.S. Treasury, Federal Reserve, FDIC Joint Press Conference, October 14, 2008, arguing that *"Many smaller, healthy banks have been losing these accounts to their much larger competitors because of uncertainties in the financial system."*

IV. The Fine Print: The Systemic Risk Exception and Eligibility

The Key Policy Issues Implicated by TLGP

Legal Issues—Applicability of the "Systemic Risk Exception"

An initial, but critical, issue in designing the TLGP was the legal foundation under the Federal Deposit Insurance Act (FDIA). Following adoption of amendments to the FDIA in the FDIC Improvement Act of 1991 (FDICIA), the FDIC is required to choose the "least costly" resolution strategy (*i.e.* the strategy that is the least costly resolution to the DIF when resolving a failing institution) when resolving failing insured banks or thrifts.

The FDIA permits an exception to the "least costly" requirement only if the "least costly" resolution "with respect to an insured depository institution would have serious adverse effects on economic conditions or financial stability" and an alternative "action or assistance" "would avoid or mitigate such adverse effects." The determination that the "least costly" resolution would have such consequences must be made by the Secretary of the Treasury, in consultation with the President, upon the recommendation of two-thirds votes of the FDIC Board of Directors and the Board of Governors of the Federal Reserve System. This is commonly referred to as a systemic risk exception.[14] Prior to 2008, the exception had never been used.

The initial legal question was whether a provision expressly permitting an exception where applying the least costly test could create systemic consequences "with respect to an insured depository institution" could be applied to a program of assistance to many financial institutions at one time.[15] The FDIC ultimately concluded that the context of the language demonstrated sufficiently that the systemic risk exception could be applied to multiple financial institutions at once if required to mitigate the "serious adverse effects on economic conditions or financial stability" the provision was designed to address. In particular, the statute did not specifically require an institution-by-institution determination of systemic risks. Moreover, the application of a "systemic risk exception" would necessarily entail situations of 'systemic relevance,' *i.e.* situations involving multiple institutions. Examined in context, the FDIC concluded, Congress inherently required an evaluation of the consequences on multiple financial institutions and therefore a program of assistance to multiple financial institutions should be permissible to address the danger to which Congress sought attention.

As a result, the FDIC concluded that the statutory language permitted the FDIC to fashion a remedy commensurate with the "serious adverse effects."[16] While this was a reasonable interpretation that provided flexibility in designing a solution to meet the

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[14] See 12 U.S.C. Section 1823(c)(4)(G).

[15] There is little legislative history on the systemic risk provision, and no conference report on the final bill.

[16] The language of Section 1823(c)(4)(G) clearly connected the use of the "least costly resolution method" for an insured depository institution to the risk of "serious adverse effects on economic conditions or financial stability" and provided broad flexibility in choosing steps that could be taken to address those "serious adverse effects" so long as those steps reasonably would help mitigate those effects. Nothing in the statute specifically limited the remedy to action to assist a single insured depository institution.

problem, it did not go unchallenged. In its later analysis, the Government Accounting Office concluded that "there are questions about these interpretations" and therefore "the statutory requirements may require clarification." As discussed below, this was done through the Dodd-Frank Act.[17]

In addition, under the FDIA the FDIC in presenting a recommendation to the Secretary must demonstrate that applying the least costly resolution would have "serious adverse effects on economic conditions or financial stability" and an alternative "action or assistance" "would avoid or mitigate such adverse effects." This question, as illustrated above, was more straightforward. As described by the FDIC in Crisis and Response, the short-term lending markets and credit markets were essentially frozen and almost no interbank lending or fed funds lending was occurring. The shocks from the then-recent failures of Lehman and WaMu, and increasing stress on other large financial institutions had led to further tightening in funding and withdrawals of deposits from some banks. The conditions amply demonstrated "serious adverse effects on economic conditions or financial stability". Although it was uncertain what effect the TLGP might have, it was designed as part of a multi-pronged U.S. governmental effort to restore some confidence to the financial system through capital intervention by Treasury and additional liquidity intervention by the Federal Reserve.

Eligibility

The policy debates over eligibility also posed significant legal questions of FDIC authority and appropriate policy.

Providing a broader guarantee of deposits was relatively simple and clearly within the FDIC's mandate. In addition, it would respond to concerns at smaller banks that only the largest money-center banks were receiving assistance so far. To partially address the potential for deposit runs by depositors with balances over $100,000, the TARP legislation included an increase in the deposit insurance coverage to $250,000. However, given the increasing liquidity stress at banks, a broader guarantee focused on business transaction accounts, which became TAGP, seemed in order.

Broad debt guarantees were different. Initially, Treasury and the Federal Reserve asked the FDIC to guarantee all bank, as well as bank and thrift holding company, liabilities. The FDIC instead proposed that DGP would apply only to new, senior unsecured debt issued by FDIC-insured depository institutions. However, Treasury and the Federal Reserve were concerned that, given the limitations of the TARP and the just announced Federal Reserve programs, this would be insufficient.

To the FDIC, extension of the proposed guarantees beyond banks posed legal and policy questions since the FDIC's powers are all focused on protection of depositors in insured banks and thrifts. The FDIC's past experience had all been focused on addressing issues at the insured depository institution level, and not at the holding company level. The systemic risk exception clearly has a potentially broader mandate and was designed to use the FDIC authority to provide "assistance" if doing so would mitigate "serious adverse

[17] See FDIC, Crisis & Response at 41; GAO, Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision at Appendix II (2010).

effects on economic conditions or financial stability". This potentially could cover U.S. bank holding companies, U.S. savings and loan holding companies, and certain types of thrift holding companies. But, could it extend beyond that?

In addition to the legal questions, the FDIC was concerned that very broad guarantees could lack credibility. The Deposit Insurance Fund had a finite balance, which had already been questioned earlier in 2008. On a financial basis, backing by the "full faith and credit of the United States" and the ability to borrow from Treasury may be sufficient. However, a pure financial analysis ignores the fragile nature of public confidence during crisis—and the importance of a "fund" available to meet depositors' claims. Guaranteeing a very broad scope of liabilities of the financial system could potentially undercut the credibility of the guarantee of insured deposits as well as of those newly guaranteed liabilities.

The Treasury and the Federal Reserve expressed concern that limiting TLGP—particularly given the limitations of TARP—could place financial companies like General Electric Capital Corporation (GECC)—at a severe disadvantage if it could not issue FDIC guaranteed debt.[18] Ultimately, the FDIC concluded that financial companies such as GECC should be included.[19] This decision was taken as the FDIC realized it was essential to allow non-banks to participate in the DGP in order to promote stability in the funding and liquidity markets.[20] However, the FDIC would have the authority to approve guarantees for nonbank affiliates of BHCs on a case-by-case basis.

With respect to GECC, for example, after discussions between FDIC Chairman Bair and Jeffrey Immelt, the CEO of GECC's parent, General Electric (GE), the FDIC approved the firm's participation. The FDIC considered GECC's capital and risk management to be solid, and since GE was then triple A rated and had agreed to guarantee the FDIC against loss, GECC's fees would help bolster the FDIC's reserves and offset potential losses in the DGP while posing limited direct risk.

The final version of the DGP included more affiliates of insured depository institutions were permitted to participate in the program, upon permission of the FDIC, granted in its sole discretion and on a case-by-case basis, after written request and positive recommendation by the appropriate Federal banking agency. In making this determination, the FDIC would consider the following factors: (1) the extent of the financial activity of the entities within the holding company structure; (2) the strength, from a ratings perspective, of the issuer of the obligations that will be guaranteed; and (3) the size and extent of the activities of the organization.

[18] General Electric Capital Corporation (GECC) was a savings and loan holding company, but it was not solely engaged in activities permissible for a financial holding company under section 4(k) of the Bank Holding Company Act. For additional details, see Mark Barber, Written Submission of GE Capital to the Financial Crisis Inquiry Commission, May 6, 2010, available at: https://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0506-Barber.pdf.

[19] Bair at 118.

[20] *See* FDIC Chairman Sheila C. Bair, Examining and Evaluating the Role of the Regulator during the Financial Crisis and Today before the House Subcommittee on Financial Institutions and Consumer Credit, May 26, 2011.

It is also noteworthy that, given the risk they could pose to the DGP, when the nine largest U.S. banks were informed that they were required to accept TARP capital on October 13th, they were likewise strongly urged to issue debt backed by FDIC debt guarantees. For these banks, TARP and DGP were inextricably tied—participation in TARP was a condition to participation in the DGP.[21] This was an important feature to the FDIC because TARP provided a measure of protection against the risk to the FDIC in the DGP. There was grave concern at that stage of the crisis that the signaling effect if one or more stronger institutions elected not to participate could lead to catastrophic consequences for weaker institutions. Similarly, there was the risk of adverse selection if only the weakest institutions elected to receive guarantees under the DGP. Given the great disparity in use of DGP by different financial companies, with Citigroup, GECC, and Bank of America by far the greatest issuers of guaranteed debt, perhaps fears over the signaling effect were overblown.[22] Nonetheless, in October 2008 it was imperative not to take such risks. Interestingly, many of the largest banks continued to use the DGP for an extended period as it provided useful support for debt issuances. For the FDIC, the presence of TARP capital—along with the other programs that assisted the largest financial companies—provided a cushion against loss precisely from those banks whose default could have devastated the DIF and impaired confidence in the deposit guarantee.

However, smaller banks were never required to participate in TARP to access DGP. For them, there was no required linkage between TARP and the TLGP. Nothing in the interim or final rules made DGP participation dependent on whether the bank or company took TARP.

After the opt-out date, only those institutions still participating in the program were subject to fee assessments. However, participation rates remained high even though continued participation was voluntary. For example, at the end of March 2009, more than 90% of insured deposit institutions with assets over $10 billion had decided to remain in the DGP. The explanation for this high rate of participation is straightforward: banks were concerned about market liquidity conditions.

V. Managing the Risk: Pricing and Operationalizing the Guarantees

In addition to the questions about authority and eligibility, implementation of the DGP required a careful delineation of several key features. First, the FDIC had to define the types of debt that would be guaranteed. Second, it was essential to define the contractual terms and condition under which the guarantee would be provided. Third, pricing for the guarantees had to be resolved. Each of these questions required drawing a balance between the imperative of strong action to stem growing banking system illiquidity and managing the risk.

Initially, a few observations about process are important. One important lesson from the development of the TLGP is the importance of incorporating available outside information and resources as well as expertise from different perspectives. Throughout

[21] Paulson at 364.
[22] See FDIC at 40.

the fall of 2008, FDIC Chairman Bair sought feedback from other regulators both for their additional information resources as well as their expertise, while also consulting with bankers, market contacts, rating agencies, advisory firms, and outside counsel to seek inputs into the internal discussions. The discussions with policymakers from other agencies were obviously critical, but those discussions were mirrored by internal discussions across a spectrum of analytical disciplines across the FDIC's supervision, research, deposit insurance, consumer outreach and legal groups, as well as consultation with members of the FDIC's Board. In retrospect, it is quite remarkable how quickly the TLGP was developed, options tested, and revised during a period of a few weeks in October and early November 2008.

Given the time pressure, dire market conditions, limited available information, and the novelty of the proposed solution for the FDIC, it was extremely challenging to balance risk management and the imperative of easing the growing funding and liquidity challenges. This latter factor was always foremost in mind. There was a strong recognition that making the terms too strict could impair the fundamental goal of reducing funding costs and loosening credit flows to the economy. In addition, if the terms were too strict there was a much greater risk of adverse selection, which could have the noted signaling effect and, in fact, increase risks to the FDIC. Conversely, terms that were too lax could yield heightened risk to the FDIC by spurring overuse and eliminating encouragement to turn to wholly private debt markets as soon as feasible.

Types of Debt. An initial definitional issue was to specify what types of debt would be guaranteed and with what maturities. While the debates over eligibility resolved whose debt would be included in the DGP, there remained the question whether pre-existing debt should be guaranteed. While it would be important to ensure that eligible institutions could roll-over existing debt if necessary, pre-existing debtholders had already made their bargain. Issuing new debt would, in contrast, allow refinancing of prior debt and continue access to the markets.

The FDIC made clear its focus on enhancing liquidity, and not creating opportunities for arbitrage in more exotic debt. There were many comments in favor of FDIC guarantees being provided to letters of credit, structured notes and derivatives more broadly, but those arguments were quickly rejected as outside the goal of improved debt liquidity. Similarly, other commenters sought longer-term guarantees to support long-term debt issuances. While the FDIC was conscious that short-term markets (30 days or under) had begun to stabilize by the November approval of the Final Rule, the risk of longer term guarantees would have extended the FDIC's guarantee exposure far beyond the horizon of expected need and impaired the transition to unguaranteed debt.

This is an important lesson—a balance must be struck between immediate government support and avoiding a longer-term dependence on a government-guaranteed market. The potential for private market distortion was a constant consideration. As a result, the FDIC agreed to guarantee all senior unsecured debt, as defined in the Final Rule, issued by a participating institution until the maturity date or June 30, 2012, whichever comes first.[23]

General Terms and Conditions. A further important operational element was to settle on the terms of the Master Agreement that eligible entities had to entered into with the FDIC in order to participate to the TLGP. The Master Agreement was to be structured in a way to facilitate the timely guarantee payments of the FDIC, while ensuring eligible institutions would timely reimburse the FDIC.

An important initial "term" was to ensure that the FDIC's guarantee was backed by the full faith and credit of the U.S. As a legal question this was relatively straightforward, but it was critical to achieving confidence in the program The Final Rule announced clearly that the FDIC's guarantee of qualifying debt under the DGP was subject to the full faith and credit of the United States pursuant to section 15(d) of the FDIA, 12 U.S.C. 1825(d). Clarity on this point also helped ensure that TLGP-guaranteed debt had a preferential risk-weighted treatment for capital purposes.

A related issue was to ensure that payments on guarantees met market expectations. Initially, as stated in the Interim Rule, the FDIC planned for payments to be made consistent with its experience with deposit insurance—upon insolvency of the issuing institution. However, through feedback from bankers, advisors, and rating agencies, it became obvious that the debt markets operated quite differently. In effect, a guarantee that was anything less than an obligation to pay all amounts due upon the issuer's nonpayment when due likely would severely curtail demand for guaranteed debt and undermine the entire goal for the DGP. Similar guarantees upon non-payment had been introduced in the United Kingdom, and this further signified the market expectation. The repayment terms specified in the Interim Rule led Standard & Poor's to raise questions whether FDIC guaranteed debt should be rated consistently with U.S. government debt.[24] If the payment on the guarantee was not "unconditional, irrevocable, and timely" and there was a risk of significant delay in payment, then the FDIC-guaranteed debt would not receive a AAA rating. This created a real concern at the FDIC that a less than AAA rating could be viewed as a vote of no confidence in the FDIC's ability to perform—including in protecting insured deposits. Once the market and rating reaction was clear, there was limited debate. Payment on the debt guarantee would be triggered by payment default rather than bankruptcy or receivership.[25] With these

[23] "Senior unsecured debt" was defined to include noncontingent, unsubordinated debt with a fixed principal amount without embedded derivatives, which could include Federal funds purchased, promissory notes, commercial paper, unsubordinated unsecured notes, including zero-coupon bonds, U.S. dollar denominated certificates of deposit owed to an insured depository institution, an insured credit union as defined in the Federal Credit Union Act, or a foreign bank, U.S. dollar denominated deposits in an international banking facility (IBF) of an insured depository institution owed to an insured depository institution or a foreign bank, and U.S. dollar denominated deposits on the books and records of foreign branches of U.S. insured depository institutions that are owed to an insured depository institution or a foreign bank. 12 C.F.R. 370.2(e).

[24] See FDIC at 48.

[25] See Final Rule, 73 Fed Reg. at 72248; Bovenzi, Inside the FDIC: Thirty Years of Bank Failures, Bailouts, and Regulatory Battles (2015) at 192.

revisions in the Final Rule, Standard & Poor's agreed that payment could reliably be expected upon payment default and provided the AAA rating.[26]

The Master Agreement also included provisions facilitating repayment. For example, the Master Agreement included a clause permitting the FDIC to recover guarantee payments made to debtholders through subrogation or assignment. In addition, the defaulting bank was required to reimburse any FDIC's guarantee payments and pay interest on any unpaid reimbursement payments at an interest rate equal to 1% of the guaranteed debt instrument.

Pricing. The dichotomy between too lax and too strict terms was perhaps most expressed through pricing. Both components of the TLGP had to generate fees to compensate the FDIC for the costs and risks of the protection, as well as to balance incentives to support liquidity while not discouraging a future movement away from government support. Pricing for the TAGP was simpler to derive since it was an extension of the pre-existing depositor protection. For the TAGP, the FDIC decided to assess eligible insured institutions as of November 13, 2008, an annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of $250,000.

Pricing for the DGP was more complex. The most salient risk was overpricing. If the price was too high, then only the most risky institutions would participate. This could have two negative consequences: signaling which institutions were weakest (though that was generally known at the time) and leaving the FDIC to guarantee debt issued only by those more desperate institutions. There was also a risk if the guarantees were underpriced. Doing so would increase the risk of substantial losses to the FDIC by undercompensating it for the risks, but it also could lead banks and affiliated companies (given the expanded eligibility) to become over-reliant on guaranteed debt thereby distorting funding markets and reducing incentives ultimately to return to normal, unsupported debt markets. The FDIC considered a variety of flat fee and calibrated fees adjusted based on risk-based factors.

In the end, the FDIC opted to try to replicate pricing for banks' funding costs in a normal market to balance these considerations. Preliminary conclusions on pricing were included in the Interim Rule which proposed to charge an annualized fee equal to 75 basis points multiplied by the amount of debt issued to all eligible debt issued by participating entities from October 14, 2008 - and still outstanding on November 13, 2008 - through June 30, 2009. Participating entities were limited to a maximum amount of guaranteed debt and also were prohibited from issuing non-guaranteed debt until the maximum allowable amount of guaranteed debt had been issued.

Pricing was not the only tool used by the FDIC to control its risk in the DGP. The Final Rule permitted the FDIC, working with an institution's primary federal regulator, to increase, reduce or restrict the institution's ability to issue debt. This tool was used extensively by the FDIC.[27]

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[26] Bovenzi at 192.
[27] FDIC at 46-47; 73 Fed. Reg 72267 (Nov. 26, 2008).

This fee structure was not immune from criticism. After issuance of the Interim Rule, the FDIC received extensive comments. Some participants criticized this pricing structure as setting fees that were too high for short-term instruments.[28] Although the initial proposed flat fee would have actually benefited many issuers, the FDIC was requested to take into account a variety of different factors to determine the appropriate fee structure, including the riskiness of the eligible entity, the term of the borrowings, the size of the financial institutions and the maturity of the guarantee debts.

The FDIC examined the consistency and implications of the proposals suggested by the industry. On the one hand, the FDIC investigated the possibility to adopt a risk-based pricing model for the DGP with guarantee fees ranging in accordance with a bank's CAMELS rating and the term of the borrowings. The FDIC concluded that a flat 75 basis point rate could make the guarantee uneconomical for shorter term debt and significantly understate its value for longer term debt. For this reason, the Final Rule incorporated a sliding scale structure for fees based on the maturity of the instruments with the following rates:

For debt with a maturity of:	The annualized assessment rate (in basis points) is:
180 days or less (excluding overnight debt)	50
181–364 days	75
365 days or greater	100

However, an extended program of debt guarantee with this pricing could have negative effects in the long run. In fact, the FDIC was very aware of the potential cliff-effect that a sudden exit from the debt guarantee scheme could have for eligible institutions. To address this, in March 2009 when the FDIC extended the program until October 31, 2009, it imposed certain fee surcharges for those institutions willing to continue their participation in the program beginning on April 1, 2009. The additional fees consisted of a surcharge on assessments of 25 basis points for insured depository institutions and 50 basis points for other participating entities for FDIC-guaranteed debt that was either issued on or after April 1, 2009 with a maturity date after June 30, 2012 or was issued after June 30, 2009.

Under the FDIA, the net cost of any use of the systemic risk exception must be recovered through a special assessment on the industry.[29] As a result, the FDIC created a separate account, similar to an escrow account, through which it recorded fees collected and expenditures for payments on guarantees. Ultimately, the TLGP was fully financed by the fees paid by participating institutions.

[28] See Final Rule at 73 Fed Reg. 72251.
[29] See 12 U.S.C. § 1823(c)(4)(G).

VI. Ten Years Later: A Critical Assessment of the TLGP

Why TLGP Proved Successful

The TLGP proved successful as a key part of a multi-faceted government response to the solvency and liquidity challenges the U.S. financial system faced in the fall of 2008. While not immune, the TGLP generally received less criticism than other government interventions. Now, ten years after it was created, it is appropriate to review a few of the successes and criticisms.

Public Acceptance: Building on Existing Programs

The FDIC benefited from a decades-long reputation as a federal agency that protected Main Street and consumers directly through deposit insurance. This is not a complex exchange: a bank fails and depositors are protected. The components of the TLGP drew directly on this relationship. In effect, the TAGP simply expanded depositor protections, while the DGP—though an enormous expansion of the FDIC's role—functioned much like insurance for debt. Both the public and the market understood guarantees, and both the TAGP and the DGP benefited both Main Street as well as Wall Street. This combination spread the benefits, and muted the outcry. A constituent who benefits in every district is a long-standing key to acceptance of any federal program.

The FDIC is popularly viewed, rightly or wrongly, as independent from the political branches of the government. In addition, by the fall of 2008, Chairman Bair was seen as an independent advocate for homeowners and depositors. As a result, the TLGP was understood as being shielded from most political pressures, thereby enhancing its popular credibility. Finally, the FDIC also actively broadcast that the TLGP was paid for by the industry, like deposit insurance. As a result, while institutions paid for other programs as well, the TGLP appeared to be viewed, like deposit insurance, as industry funded.

Guarantees Provide Efficient Use of Resources

In addition to being understandable, guarantees are financially efficient both in providing benefits where they are needed and in using available resources. For accounting purposes, the estimates of the cost of the DGP and TAGP were based on expected losses, not on the total volume of assets or deposits guaranteed. This permits guarantees to leverage available resources and potentially to have a much greater economic effect given the same resources in comparison to equity injections or asset purchases. This is a principle that the FDIC has long used in its loss-share and related programs for the resolution of banks and thrifts. While equity injections and asset purchases were necessary components of a broad-based program in a 2008-sized crisis, they do not provide the same targeting of benefits or leveraging of resources.

The TLGP targeted the guarantee benefits to discrete operations—deposit and debt funding. This both ensured that the program could, and likely would, be used by a large number of banks and, with the eligibility expansion to affiliated entities, by a very large number of entities. This potential widespread targeted application was one of the reasons for the FDIC's focus on controlling risks, defining terms and conditions, and calibrating pricing. As noted above, the main purpose of the TLGP was to permit eligible institutions to meet their liquidity needs during a period of severe funding distress, helping the credit market to restore its transmission channels in times of economic recession and financial downswings. By design, the TLGP focused most directly on allowing eligible financial institutions to roll-over and issue debt by providing a critical back-stop guarantee. This focus was possible because the TLGP was only one part in a multi-pronged U.S. governmental effort to stabilize the financial markets. As funding became more stable, the liquidity positions of banks that opted into the TLGP improved substantially.

Efficient Pricing and Absence of Losses to DIF

Another common measure of success is whether a program suffered a net loss. Under this measure as well the TLGP was a success. For the DGP, the FDIC was able to collect more than $10 billion in fees and surcharges, while paying only $153 million for losses. For the TAGP, the FDIC collected $1.2 billion in fees while the cumulative losses at the end of 2016 amounted to $1.5 billion.[30] As a result, the gains derived from the TLGP substantially outweighed the FDIC's disbursements, with a net total of about $9.3 billion in fees deposited into the DIF.

The pricing structure of the TLGP was risk-based. While there has been considerable debate since the program ended about whether the FDIC properly priced the DGP and TAGP, these criticisms must be considered within the overall context of the goals of the program as well as other controls for risk used by the FDIC. As noted above, the TLGP was simply one part of a governmental response to the extraordinary loss of liquidity and risks to solvency during the fall of 2008. TARP, the CPFF, and the TLGP together were intended to provide a cohesive response that would help stabilize the financial system. The FDIC was conscious of the need to balance risk-based pricing against the imperative to reverse the growing slide to market illiquidity. And, the FDIC had other tools to control its risks. While the FDIC priced the debt guarantee at levels slightly above normal market conditions, it consciously priced the DGP guarantee well below the then-current costs of credit default spreads, which helped reopen the debt markets to eligible entities. The FDIC also sought to control its risks by a number of other mechanisms. As noted above, the FDIC used the discretion provided by the Final Rule to place limitations on the terms and debt it would guarantee for weaker institutions.

Evidence of Liquidity Improvements

Although no precise data are available on the fractional contribution of the TLGP to the liquidity improvements in 2008 and 2009, it is generally recognized that banks' liquidity positions could not be restored without the implementation of the DGP. While other policy interventions from the Federal Reserve and the US Treasury were certainly critical

[30] See FDIC at 58.

to the easing of the stress on the financial system, the TLGP played a vital role in supporting liquidity for eligible financial institutions.

Immediately after the announcement of the combined U.S. governmental effort on October 14th, the cost of LIBOR interbank credit declined by 446 basis points, and the TED spread (3 Month LIBOR / 3 Month Treasury Bill) declined by 443 basis points. Additional contributions to liquidity improvements can be observed in the easing of short-term and intermediate-term funding markets.

Criticisms

Changes to FDIC authority to provide liquidity support in Dodd-Frank Act

As noted above, the Congress did not really focus on the TLGP at the time of its implementation. However, in the years leading to the Dodd–Frank legislation, the Congress took the stance to limit, if not prohibit, a possible repeat of the TLGP without explicit Congressional approval. This position found its rationale in the idea of limiting the FDIC's discretionary authority, should another crisis occur in the coming years. The use of the systemic risk exception under the TLGP led the FDIC in an uncharted domain which, in the eyes of the Congress, could give the Agency too much discretion in the interpretation of the relevant statutes and too large scope in the execution of its statutory powers.

Against this backdrop, the Dodd-Frank Act repealed the use of the systemic risk exception, imposing regulatory constraints on the creation of future liquidity programs akin to the TLGP. Based on Title XI, the FDIC can now create a program to guarantee obligations of solvent insured depository institutions, holding companies or affiliates in times of severe economic distress, only when an official determination that a liquidity event exists. This liquidity determination includes a written evaluation of the evidence that a liquidity event is occurring and requires an affirmative two-thirds vote of both the board of the FDIC and Board of Governors of the Federal Reserve. Under the Dodd-Frank Act, the guarantee program would be funded by fees and assessments paid by all participants in the program. Moreover, any excess funds would be deposited in the General Fund of the Treasury. More importantly, the FDIC is no longer allowed to issue guarantees until the Congress formally approves such a program.

The Dodd-Frank Act amendments inevitably limit the FDIC's flexibility in dealing with liquidity shocks during future financial crisis. Given these constraints, it will be more difficult in the future for the FDIC to implement a similar program in a timely fashion.

VII. Lessons for the Future

Key Lessons for Future Policymakers for the Next Crisis

There are many lessons that could be drawn by the development and implementation of the TLGP. However, there are a few in particular that bear note.

LESSON 1: GUARANTEE PROGRAMS CAN PROVIDE TARGETED SUPPORT AND EFFICIENTLY LEVERAGE AVAILABLE RESOURCES. The TLGP was only one part of the coordinated government response to the capital and liquidity threats in the fall of 2008. Liquidity alone could not address that crisis. As part of that effort, the TLGP did effectively deploy guarantees to assist the funding markets by supporting a restart in the debt markets and by stemming risks of deposit runs. Along with other tools, guarantees can provide an efficient mechanism to support existing market practices, rather than replacing them, and may be particularly suited to ease the return to an unsupported market. The FDIC had to address the potential cliff effect from the termination deadline, but appeared to achieve a gradual weaning of the market from the guarantees through stepped up surcharges.

LESSON 2: MARKET AND PUBLIC SUPPORT, OR AT LEAST MUTED OPPOSITION, ARE IMPORTANT CONSIDERATIONS IN ANY INTERVENTION. Public policy in the U.S. has been marked for the past ten years by reactions to the government interventions in 2008. The TLGP appeared to garner relatively good public acceptance probably because it was an extension of a long-supported program, deposit insurance, and because it provided a direct benefit to depositors through the TAGP. In addition, the TLGP was viewed as an industry-funded program in a way that TARP and the Federal Reserve liquidity programs were not because their repayment occurred over years. The use of guarantees also contributed to this acceptance because of the apparent simplicity of this approach and its similarity to deposit insurance and other popular programs, such as guaranteed loans for small businesses. In effect, the perceived social cost of this liquidity support measure is pretty low, while the benefits for the markets, and the economy as a whole, can be substantial.

LESSON 3: EFFECTIVE TARGETING OF GOVERNMENT SUPPORT HINGES ON A CLEAR UNDERSTANDING OF THE MARKET AND MARKET PARTICIPANTS' NEEDS. The development of the TLGP was marked by repeated discussions with governmental and private sector stakeholders in an effort to ensure that the program was targeted and elaborated in a way that accomplishes the desired goals. For example, in tailoring the TLGP, the FDIC fortunately responded to feedback after the Interim Rule by incorporating changes to address market requirements to include certain specific mechanics, such as a procedure for timely payments of debt guarantees. Future policymakers should ensure that they are open to outside input and analysis and incorporate this feedback in developing any programs like the TLGP.

LESSON 4: GOVERNMENT ACTORS MUST WORK ACROSS AGENCIES IN DEFINING THE NEED AND DEVELOPING A COORDINATED RESPONSE. The TLGP would not have been successful alone. It was critical for the relative success of the governmental effort in the fall of 2008 that the TLGP was part of a combined effort with TARP and CPFF as well as future initiatives by the FDIC, Federal Reserve, and

Treasury. The severity of the crisis clearly demanded it. However, even in a less severe crisis it is critical to assess how different authorities can deploy different initiatives to achieve a coordinated response. This approach is essential to improving consumer, market and institutional confidence, which itself is a key element in any successful intervention.

LESSON 5: BE FLEXIBLE. This is paramount. All government agencies are bound by their statutory authorities and missions. But, in a crisis, solutions may depend on the creative application of pre-existing tools, and a clear understanding of when additional authority may be needed. The development of the TLGP exemplified flexibility in interpreting statutory authority and considering new options permitted by the FDIC's authority and mission. Other authorities, clearly including Treasury and the Federal Reserve, exercised creativity and flexibility in tailoring their tools and resources to meet the crisis. Without openness to considering such steps, the U.S. response to the crisis would have been hamstrung from the start.