FDIC Guaranteed Bank Debt

BLACKROCK

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In an effort to mitigate growing risk aversion following the Lehman bankruptcy, the FDIC created the Temporary Liquidity Guarantee Program (TLGP) on 14 October 2008. The Program is intended to promote confidence and liquidity in the banking system by eliminating counterparty risk through the guarantee of newly-issued senior unsecured debt of all FDIC-insured institutions, bank and financial holding companies, and select savings and loan holding companies.

The FDIC guarantees senior unsecured debt with a maturity of more than 30 days, including commercial paper. Coupons may be fixed, floating, or zero. The securities may be denominated in any currency, but the Program precludes debt with embedded options and structured notes.

The FDIC has stated that the guarantee of timely payment of interest and principal carries the full faith and credit of the US government. Consequently, the three major rating agencies are treating these securities like top-tier government debt with a rating of AAA/A-1+. The debt guarantee extends until 30 June 2012. Therefore, all TLGP debt that matures on or before that date is fully guaranteed. (None of the debt matures beyond the guarantee date.) In February of this year, the issuance window was extended for all FDIC-insured institutions until 31 October 2009 from the original date of 30 June.

The size of the Program is designed to accommodate the significant amount of short-term bank debt maturing in the next year. Each financial institution may issue up to 125% of senior unsecured debt coming due between 30 September 2008 and 30 June 2009**.** As of 6 March, $182 billion in FDIC-guaranteed paper has been issued through the Program overall, of which $173 billion is USD-denominated. The Barclays Capital Indices classify this new sector as similar to Agency debt, where it currently represents 1% of the Aggregate Index.

We have observed that the advent of debt guarantee programs, such as this one, can precipitate a crowding out effect with similar asset classes. Agency debt has underperformed recently as it competes for demand with the FDIC-guaranteed paper. However, the Program has been a welcome development for the marketplace, serving to alleviate investor concerns regarding the credit quality of these financial institutions and providing a broader spectrum in top-rated paper.

The debt issued under this Program has fared quite well. For example, in the US, the three-year paper initially was priced 80 to 90 basis points over LIBOR. It has tightened significantly since its debut, trading at 10 to 15 basis points over LIBOR. Going forward, we expect to see modest tiering in spreads among issuers with a global footprint who are able to issue larger deal sizes relative to smaller entities that are less well-known.

Broadly, liquidity in the sector thus far has been reasonably good, with bid-offer spreads roughly in line with comparable Agency debt. Liquidity has been tighter in the secondary market, and some issuers have priced new issues at a concession to the secondary market. As a result, it has been preferable to execute large block trades in the primary market when adding exposure across portfolios. With Treasury yields falling to very low levels, the TLGP provides an attractive opportunity to own fully government-guaranteed paper at more attractive yields. In BlackRock client portfolios that allow the purchase of these securities, we hold a neutral to slightly overweight position versus the benchmark index.

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Figure 1. TLGP Issuance ($ in millions)

Issuer	Estimated Original Capacity	Issuance to Date	Estimated Remaining Capacity[1]	Issuance as a % of Original Capacity
Bank of America	115,308	35,500	79,808	31%
GECC	138,750	26,700	112,050	19%
Citigroup	101,575	20,600	80,975	20%
JPMorgan	110,888	20,000	90,888	18%
Morgan Stanley	39,906	19,075	20,831	48%
Goldman Sachs	25,464	15,225	10,239	60%
Wells Fargo	64,350	6,000	58,350	9%
American Express	13,495	5,900	7,595	44%
Regions	7,291	3,750	3,541	51%
SunTrust	3,923	3,000	923	76%
PNC	11,989	2,900	9,089	24%
John Deere	5,093	2,000	3,093	39%
Sovereign	4,811	1,600	3,211	33%
KeyCorp	2,340	1,500	840	64%
NY Community Bancorp	602	602	0	100%
Huntington	963	600	363	62%
Zions	1,387	254	1,133	18%
US Bancorp	7,442	-	7,442	-
Bank of New York Mellon	6,437	-	6,437	-
M&I	5,352	-	5,352	-
State Street	5,295	-	5,295	-
Comerica	5,169	-	5,169	-
Fifth Third	4,780	-	4,780	-
UnionBanCal	3,593	-	3,593	-
First Horizon	3,093	-	3,093	-
Northern Trust	2,823	-	2,823	-
BB&T	2,419	-	2,419	-
Capital One	2,404	-	2,404	-
Associated	2,270	-	2,270	-
Popular	2,166	-	2,166	-
BOK Financial	2,125	-	2,125	-
M&T	1,143	-	1,143	-
Synovus	843	-	843	-
Discover	584	-	584	-
Colonial	475	-	475	-
Grand Total	706,548	165,206	541,342	-

[1]Capacity reflects FDIC-eligible maturities from 30 September 2008 to 31 October 2009

Source: BlackRock, Inc, Company Public Filings

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