

The Treasury Liquidity Guarantee Program (TLGP): Opportunity in Short-Maturity FDIC-Backed Bonds

Amidst the alphabet soup of bailouts, guarantees, facilities and other assorted programs, one in particular sticks out as an opportunity for conservative investors seeking some relief from the pain inflicted upon them from the government's current wealth transfer from creditors to debtors. This is the Treasury Liquidity Guarantee Program (TLGP) under which financial institutions (by means of an FDIC guarantee) are able to access the short-term debt markets without having to pay punishingly high yields.

The Federal Deposit Insurance Corporation (FDIC) is best known for its role in providing deposit insurance. Its official status is as an independent agency of the federal government. It is financed by the premiums it charges banks and thrifts for providing insurance protection, as well as by the earnings on its investments in U.S. Treasuries. According to the FDIC website, "[s]ince the start of FDIC insurance on January 1, 1934, no depositor has lost a single cent of insured funds as a result of a failure."

With the seizing up of the credit markets last year the U.S. government enacted the TLGP in order to "strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount."* Access is not automatic, however, as an application must be approved by the FDIC. Initially, such FDIC-backed debt had to be issued before April 1, 2009 with the guarantee set to expire on June 30, 2012, but the FDIC recently extended the window for issuance until October 31,

2009 and the expiry of the guarantee until December 31, 2012 (albeit at a higher premium than was initially charged to the issuing institutions for the guarantee – the idea being to wean issuers off the program and to encourage them to seek other funding sources).

To date, more than \$200 billion of FDIC-guaranteed debt has been issued since the first deals were brought to market in November 2008, most of which are \$1 billion or larger in size. Given the benchmark sizes, as well as extremely strong confidence in the validity of the guarantee on the part of the market, liquidity for FDIC-guaranteed issues has been much better than has been the case for the corporate bond market as a whole – a situation we would expect to continue.

When compared to other alternatives currently available, we find FDIC-backed debt attractive. The yields are paltry on cash instruments, and while certificates of deposit can provide better yield, it comes at the cost of markedly lower liquidity. With the 2- and 3- year U.S. Treasuries currently trading around .9% and 1.3% respectively, an investor would need to extend out to around a November 2015 maturity on the Treasury bond curve to match, for example, the yield available on the recent FDIC-backed JPMorgan December 2012 issue (currently trading around .85% over the 3-year treasury for approximately 2.15% yield to maturity). At a time of near historically low yields and record U.S. Treasury issuance to fund the stimulus package, this seems an unattractive tradeoff, in our opinion.

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* www.fdic.gov/regulations/resources/TLGP

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Accordingly, given their high quality, low interest rate risk (due to their short-term maturity), impressive liquidity, and respectable incremental yield over U.S. Treasuries, we see FDIC-backed issues as a compelling “parking place” amidst the current market turmoil.

-Eric Maisel, CFA

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