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The Treasury's Capital Purchase Program: Understanding the Fine Print

Web Conference

Thursday, October 30, 2008

4 p.m. Eastern

Presented by

Foley's Financial Crisis Response Team

Register at

Foley.com/CPP

October 2008

The Treasury's Capital Purchase Program: Understanding the Fine Print

On October 14, 2008, the United States Department of the Treasury announced the availability of its voluntary Troubled Asset Relief Program (TARP) Capital Purchase Program (CPP) for qualifying public financial institutions (QFIs) such as U.S.-controlled banks, savings associations, and certain bank and savings-and-loan holding companies. Through the CPP, the Treasury seeks to enhance the capital bases of domestic financial institutions in an effort to thaw the credit markets and enable the flow of financing to businesses and consumers.

Please join us for a Web conference for comprehensive analysis of the government's financing initiatives.

When
Thursday, October 30, 2008
4 p.m. Eastern

Registration
To register, please visit **Foley.com/CPP** or contact Emory Ireland at 414.297.5624 or eireland@foley.com.

While the CPP presents significant opportunities and benefits, it is imperative for any interested QFI to understand fully the requirements and conditions of CPP participation. On Thursday, October 30, 2008, at 4:00 p.m. Eastern, the Financial Crisis Response Team of Foley & Lardner LLP will present a Web conference providing comprehensive analysis of the government's financing initiatives. To register, please visit **Foley.com/CPP** or contact Emory Ireland at 414.297.5624 or eireland@foley.com. An overview of the CPP follows.

The Treasury had originally made $250 billion of senior preferred stock financing on standardized terms to QFIs that elect to participate in the CPP by November 14, 2008. Nine large financial institutions already have agreed to participate in the CPP in an aggregate amount of $125 billion, leaving $125 billion available to qualifying small- and medium-sized banks and thrifts across the nation. The minimum subscription amount available to a participating QFI is one percent of its risk-weighted assets and the maximum amount available is three percent of its risk-weighted assets. All funding under the CPP for participating QFIs is scheduled to be completed by December 31, 2008.

The Treasury will determine eligibility and allocations for interested QFIs after consultation with the appropriate federal banking agency.

CPP Summary

The perpetual-term senior preferred stock financing to be provided by the Treasury will qualify as Tier-1 capital and will rank senior to any common stock and equal to any issued existing preferred shares (other than any specifically designated junior preferred shares) of the participating QFI. The senior preferred shares will generally pay a five-percent annual cumulative dividend for the first five years and will reset to nine percent annually thereafter, payable quarterly. The preferred shares will be non-voting, other than class voting rights on matters that could adversely affect the preferred shares (and the right to elect two directors if there are six uncured quarterly dividend defaults). The preferred shares will be callable by the QFI at par (plus any accrued and unpaid dividends) after three years. During the first three years after issuance, the senior preferred stock may be redeemed at par (plus any accrued and unpaid dividends) by the QFI with the proceeds from a "qualifying equity offering" of any Tier-1 perpetual preferred or common stock resulting in gross proceeds of not less than 25 percent of the amount of senior preferred stock originally issued to the Treasury. Certain restrictions will be imposed on the QFI's ability to pay dividends on, or repurchase, its common stock (and any junior preferred stock) if there is any dividend default on the senior preferred stock. Additionally, for the first three years that the senior preferred stock is outstanding and remains held by the Treasury, the Treasury's consent will be required for the QFI to increase any cash dividends on, or repurchase any of, its common stock.

As a condition to receiving the preferred stock financing, the QFI must issue warrants to the Treasury with a 10-year term to purchase the number of the QFI's common shares having an aggregate market price equal to 15 percent of the Treasury's senior preferred investment. The number of shares subject to the warrants shall be reduced by 50 percent if the QFI redeems all of the senior preferred shares through a qualified equity offering prior to December 31, 2009. The warrants' exercise price will be based on the 20-trading day pre-issuance average market price of the QFI's common stock. Following the QFI's redemption of all of its senior preferred stock, the QFI also may redeem its warrants (and any issued underlying common stock) held by the Treasury at fair market value. The Treasury will not vote any common shares issued to it upon exercise of its warrants.

The participating QFI must allow the Treasury the ability to transfer its senior preferred stock and/or warrants (and underlying common stock) to any third party at any time, and the QFI must file a shelf registration statement (and provide piggyback registration rights) to facilitate the Treasury's sale of its equity securities of the QFI. However, the Treasury may only exercise or transfer one-half of its warrants prior to the earlier of the date of any complete redemption of the preferred stock or December 31, 2009.

A QFI participating in the CPP must implement the Treasury's standards for executive compensation for the period during which the Treasury holds any equity in the QFI. These standards include:

- Ensuring that incentive compensation for senior executives does not encourage "unnecessary and excessive risks" that threaten the value of the QFI
- Requiring a clawback of any bonus or incentive compensation paid to a senior executive based on materially inaccurate financial statements or criteria
- Prohibiting any "golden parachute" payment to a senior executive
- Agreeing not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive

These standards generally apply to the chief executive officer and the chief financial officer, along with the next three most highly compensated executive officers.

Copies of the Treasury's standard term sheet for its CPP preferred stock financing, Application Guidelines for TARP Capital Purchase Program, the Application for TARP Capital Purchase Program, and Process-Related FAQs for Capital Purchase Program are available at **Foley.com/CPP**.

A Private Market Alternative

Foley has developed a financing option for banks, thrifts, and related holding companies that may complement the CPP or be an alternative to the CPP. This option addresses both the need to remove distressed assets from financial statements and the need to raise capital that is depleted as a result of the distressed assets.

Our option uses the CPRes Security℠. The CPRes Security℠ is a paired security that consists of an interest in a liquidating entity and an interest in preferred stock. The financial institution that issues the CPRes Security℠ contributes its distressed assets to a special purpose entity (SPE). The fundamental value of the SPE is then determined. The difference between the SPE's fundamental value and the value of the distressed assets on the financial statements of the financial institution is equal to the amount of the preferred stock (Tier-1 capital) that underlies the CPRes Security℠.

A CPRes Security℠ transaction provides a financial institution with great flexibility. Unlike the TARP program, a CPRes Security℠ transaction does not require any changes to an issuer's executive compensation programs. In addition, an issuer's distressed assets may be addressed in a single transaction, and can include distressed assets other than mortgage-backed securities.

Unlike the terms of the preferred stock issued in the CPP, the preferred stock issued in a CPRes Security℠ transaction may not have warrant coverage. In addition, the preferred stock issued in a CPRes Security℠ transaction may convert into common stock at a multiple other than one-to-one, depending upon the upside participation interest the financial institution wishes to retain in the SPE.

If you would like to learn more about the CPRes Security℠, please contact Michael B. Kirwan at 904.633.8913 or mkirwan@foley.com.

About Foley

Foley & Lardner LLP continually evolves to meet the changing legal needs of our clients. Our team-based approach, proprietary client service technology, and practice depth enhance client relationships while seeing clients through their most complex legal challenges. The BTI Consulting Group (Wellesley, Massachusetts) recently recognized Foley as one of the top four law firms shaping the U.S. legal market, while *CIO* magazine has named Foley to its CIO 100 list six times for our client-focused technology. Whether in the United States or around the world, Foley strives to provide high-caliber business and legal insight.

About Foley's Financial Crisis Response Team

With the unprecedented restructuring of U.S. financial markets and institutions, many businesses and individuals now face a host of new and evolving challenges and opportunities. As the Bush administration, U.S. Congress, and regulatory agencies attempt to address this crisis, Foley's Financial Crisis Response Team enables corporations, financial service providers, and individuals to understand the implications and opportunities resulting from legislative and regulatory actions and the aftermath of the financial turmoil.

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