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Treasury Department Updates

On Monday, November 17, 2008, the Treasury Department issued a term sheet and FAQ for non-public institution participation in the Capital Purchase Program (the "CPP"). Applications must be filed by **December 8, 2008**. This program is not available to S-Corporations or mutual depository institutions; a program for them is still under consideration.

The term sheet and FAQ can be found on the Treasury Department website: http://www.treas.gov/press/releases/hp1277.htm

Eligible Institutions

Any non-public bank holding company, savings and loan holding company, and any U.S. non-public stock bank or savings association without a holding company that is not publicly traded is eligible to apply for participation. A company is considered to be "public" or "publicly traded" if its securities are traded on a national securities exchange ***and*** it is required to file periodic reports with the Securities and Exchange Commission or its primary federal bank regulator.

Key Differences for Non-Public Institutions

Many of the terms of the CPP for non-public institutions are identical to the terms previously issued for public institutions, including terms regarding size of investments (1% to 3% of risk-weighted assets), preferred term dividends (5% for the first five years and 9% thereafter), redemption provisions and executive compensation requirements. The application is subject to a condensed timeline, much like the application for public institutions. The following are key differences in the CPP requirements as applied to non-public institutions:

- **Common Dividend Restrictions:**
  - Public- Treasury consent is required for any increase in common dividends until the third anniversary of the date of investment. No

restrictions are imposed on common dividends after the third anniversary provided that all accrued and unpaid dividends for all past dividend periods on the preferred shares are fully paid.

  - Non-Public- Treasury consent is required for any increase in common dividends until the third anniversary of the date of investment. In addition, after the third anniversary and prior to the tenth anniversary, Treasury consent is required for any increase in aggregate common dividends per share greater than 3% per annum while the preferred shares are outstanding. No dividends may be paid after the 10th anniversary if the preferred have not been redeemed prior to that date.

- **Warrants**:
  - Public- Treasury will receive warrants to purchase a number of *common shares* having an aggregate value equal to 15% of the amount of the senior preferred investment. The initial exercise price for the warrants will be the average closing price of the common stock over a 20-trading day period preceding the Treasury's approval of the CPP application.
  - Private- Treasury will receive warrants to purchase a number of *preferred shares*having an aggregate liquidation value equal to 5% of the amount of the preferred investment. The initial exercise price of the warrants will be $0.01 per share (or such greater amount as the institution's charter may require). The Treasury intends to immediately exercise the warrants. The warrant preferred shares will pay dividends at a rate of 9% per annum and cannot be redeemed until all preferred shares are redeemed.
    - Treasury may exempt certain investments from the warrant requirements for non-public institutions if:
      - the size of the investment is less than $50 million, and
      - the institution is a certified Community Development Financial Institution ("CDFI"), which is a specialized financial institution that focuses on an underserved market niche. CDFIs include financial institutions providing mortgage financing to low-income homebuyers, flexible underwriting for needed community facilities, and commercial loans to start-up businesses in low-income areas.
    - An institution may file an application for certification as a CDFI by December 8, 2008. Once the institution has applied for CDFI certification and it is eligible for funding under the CPP program, it will receive conditional approval, contingent on receipt of the CDFI certification.
    - The CDFI certification must be approved by January 15, 2009.
- **Repurchase Restrictions:**
  - Public- The institution may not repurchase any securities junior to the preferred, including common stock, until the third anniversary of the investment without Treasury consent. No restrictions are imposed on repurchases of common stock after the third anniversary provided that all accrued and unpaid dividends for all past dividend periods on the preferred shares are fully paid.
  - Non-Public- The institution may not repurchase any securities junior to the preferred, including common stock, until the tenth anniversary of the investment without Treasury consent. No repurchases of common stock will be permitted after the tenth anniversary if preferred shares remain outstanding.
- **Related Party Transactions:**

- Non-Public - While the Treasury holds any equity securities, the institution and its subsidiaries may not enter into certain transactions with related persons (*i.e.*, the institution's executive officers, directors, director nominees, or immediate family of the foregoing), unless:
- the transactions are on terms no less favorable to the institution than could be obtained from an unaffiliated third party, and
- have been approved by the institutions audit committee or comparable body.

Policy Shift: From TARP to CPP

On November 12, 2008, Secretary Paulson announced the Troubled Asset Relief Program would not be implemented as originally imagined. Paulson's statement was a public recognition of the shift from the TARP to the Capital Purchase Program, a shift that occurred in October when the CPP was announced.

This statement likely came in response to criticism about the use of CPP funds, specifically, participating institutions' use of Treasury capital injections to purchase healthy banks. In his statement, Paulson encouraged banks to continue lending, but as of now, the Treasury has not created any penalties regarding how the funds must be used. Paulson also said the Treasury Department was examining extending the program to non-bank financial institutions not eligible for the current capital program.

The Treasury Department has not announced how the remaining funds will be used, but Paulson suggested Treasury may retain the remaining $60 billion for emergencies. Federal Deposit Insurance Corporation has proposed a foreclosure mitigation plan, but Paulson stated that the Treasury would rather invest the money, and not spend it outright.

Senate Majority Leader Harry Reid plans to introduce legislation contributing aid to the auto industry, but it is unlikely the bill will pass before Congress adjourns for the year. Paulson has already said that the remaining TARP money will not be spent on an automaker bailout and reaffirmed his stance in the Tuesday hearings before the House Financial Services Committee.