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The Emergency Economic Stabilization Act of 2008
The Capital Purchase and FDIC Guarantee Programs

On October 14, 2008, the United States Treasury Department (Treasury), the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) jointly announced additional programs pursuant to the Emergency Economic Stabilization Act of 2008 (EESA) to address the current instability in the financial markets. These programs, more fully discussed below, include the:

- **Capital Purchase Program (CPP)** – whereby Treasury will purchase up to $250 billion in senior preferred shares from healthy qualifying financial institutions (QFI).

  - Treasury has already purchased $125 billion of senior preferred shares from the nine largest QFIs.
  - The preferred shares will count as Tier 1 capital and will pay a cumulative dividend of 5% for the first 5 years, and 9% thereafter.
  - The minimum Treasury purchase is 1% of a QFI's risk weighted assets, and the maximum purchase is 3% of risk-weighted assets or $25 billion, whichever is less.
  - In connection with the purchase of preferred shares Treasury will receive warrants to purchase common stock in an amount equal to 15% of the senior preferred investment.
  - Participating institutions will be subject to restrictions on dividend payments, share repurchases and executive compensation.
  - A QFI must elect to participate by November 14, 2008.

- **Temporary Liquidity Guarantee Program (TLGP)** – whereby FDIC will: (i) guarantee newly issued *senior* unsecured debt issued by any QFI on or before June 30, 2009, including promissory notes, commercial paper, interbank funding and the unsecured portion of any secured debt; and (ii) provide unlimited FDIC insurance coverage for non-interest bearing transaction accounts.

  - The guarantee will allow a QFI to roll over maturing senior debt into newly issued debt backed by FDIC.
  - The guarantee program is available only to a QFI that had existing senior unsecured debt outstanding as of September 30, 2008.
  - Subordinated debt will not be guaranteed.
  - The guarantee/ additional insurance coverage is *automatic* under TLGP for the first 30 days without charge. Thereafter, there will be a 75 basis points charge for the guarantee and a 10 basis points assessment for insurance above $250,000.
  - Institutions have until November 14, 2008 to *opt out* of TLGP. Therefore, QFIs must contact Treasury/FDIC by this date if they do *not* wish to participate in these programs.

Capital Purchase Program

<u>*Eligibility*</u>. The CPP is available to all QFIs, which include U.S. controlled/FDIC-insured banks and savings banks/savings associations, as well as bank holding companies and savings and loan holding companies engaged only in activities permitted for financial holding companies under Section 4(k) of the Bank Holding Company Act (real estate development is not permitted under Section 4(k)). Treasury will determine eligibility and allocations for interested parties after consultation with the appropriate federal banking agency. The CPP is not intended to be a troubled institution resolution program.

A QFI must elect to participate in the CPP on or before November 14, 2008.

- It is unclear whether the filing of an election to participate commits a QFI to issue the preferred shares to Treasury.
- It is unclear at this time whether all or any particular portion of the proceeds must be invested in a subsidiary bank if the senior preferred shares are issued by a holding company.

The minimum subscription amount available to a participating institution is 1% of risk-weighted assets. The maximum subscription amount is the lesser of $25 billion or 3% of risk-weighted assets. Treasury will fund the senior preferred shares purchased under the program by year-end 2008.

Terms/Conditions of Senior Preferred Shares. The senior preferred shares will qualify as Tier 1 capital and will rank senior to common stock and equally with existing preferred shares, other than preferred shares which by their terms rank junior to any other existing preferred shares. The senior preferred shares will pay a cumulative annual dividend of 5% for the first five years and thereafter a 9% annual dividend. The senior preferred shares will be non-voting, except on matters that could adversely affect the preferred shares.

The senior preferred shares will be callable at par after three years. Prior to the end of three years, the preferred shares may be redeemed only with the proceeds of a qualifying equity offering of Tier 1 perpetual preferred or common stock. Treasury may transfer the senior preferred shares at any time.

As part of any purchase of senior preferred shares, Treasury will receive warrants to purchase common stock with a term of 10 years at an aggregate market price equal to 15% of the senior preferred investment. The exercise price of the warrants will be the market price of the participating institution's common stock at the time of the preferred issuance, calculated on a 20-trading day trailing average.

The warrants will be exercisable immediately, in whole or in part, and will be transferable, subject to certain limitations. Treasury will not vote any shares of common stock acquired upon exercise of the warrants (upon transfer, the shares can be voted). If the participating institution completes one or more qualifying equity offerings before December 31, 2009 that raises gross proceeds equal to or more than the aggregate purchase price of the senior preferred shares, the number of warrants will be reduced by 50%. If the participating institution is not publicly traded, or ceases to be listed, Treasury may take, or, in the case of delisting, exchange the warrants for, senior term debt or other instrument with comparable value. The warrants will not be subject to any restrictions on transfer, provided that only one-half of the warrants may be transferred prior to the earlier of: (i) the date on which the QFI has received aggregate proceeds of not less than 100% of the issue price from one or more qualified equity offerings; or (ii) December 31, 2009.

The senior preferred shares, warrants and common stock underlying the warrants must each be covered by a shelf registration statement to be declared effective with the SEC "as soon as possible." Piggyback registration rights must be granted to Treasury with respect to the preferred shares.

- It is unclear whether Treasury will purchase preferred shares from a QFI that is not registered with the SEC, or that will not commit to such registration (which in effect a shelf registration will require).
- A "shelf offering" is more practical for companies with larger market capitalization.

Restrictions on Executive Compensation. As a condition to Treasury's investment in senior preferred shares and for as long as any equity or debt securities are held by Treasury, a QFI *must modify or terminate all benefit plans, arrangements and agreements to comply* with the executive compensation and corporate governance standards of Section 111 of EESA. These standards will apply to senior executive officers (SEOs) (defined to include the chief executive officer, chief financial officer and the other three highly compensated executive officers) and will:

- require limits ensuring that incentive compensation for SEOs does not encourage unnecessary and excessive risks that threaten the value of the financial institution. The QFI's compensation committee will be required to review such arrangements and certify this standard has been met;
- require recovery or "claw back" of any bonus or incentive compensation paid to an SEO

based on financial statements that are materially inaccurate;
- prohibit "golden parachute" payments to SEOs (which are benefits related to an involuntary termination of employment, bankruptcy, insolvency or receivership whether or not involving a change in control, the present value of which equal or exceed 3x the 280G "base amount"); and
- limit the tax deductibility of compensation to any SEO in excess of $500,000.

As a further condition to closing an investment in senior preferred shares, SEOs must grant Treasury a waiver releasing it from any claim relating to compensation that may be affected by regulations adopted by the Treasury from time to time.

Treasury has issued interim final rules for these executive compensation restrictions.

Dividend and Share Repurchase Restrictions. Treasury's consent is required for (i) any increase in common stock dividends, and (ii) common share repurchases, until the third anniversary of the investment, unless all senior preferred stock has been redeemed or transferred to a third party. The standards Treasury will use for approval of dividend increases/share repurchases are unknown at this time.

Availability for Mutual Institutions and Mutual Holding Companies (MHCs). Mutual institutions operating in the MHC structure are eligible to participate in the CPP. However, regulatory waivers may be necessary in connection with any issuance of warrants to Treasury as part of a senior preferred issuance, as well as any shelf registration. Mutuals not operating in the MHC structure have no authority to issue preferred stock, and it is not clear how the CPP could be modified to allow mutuals to issue debt in lieu of senior preferred shares that would qualify as Tier 1 capital.

FDIC's Temporary Liquidity Guarantee Program

The TLGP is available to any QFI and contains two key features.

First, the FDIC will guarantee newly issued senior unsecured debt issued by any QFI, including promissory notes, commercial paper, interbank funding (*e.g.*, fed funds) and the unsecured portion of any secured debt. The guarantee will allow a QFI to roll over maturing senior debt into new issues backed by the FDIC, but a QFI cannot pre-pay a debt to be replaced by a guaranteed debt. The amount of debt covered by the guarantee may not exceed 125% of the senior, unsecured debt that was outstanding as of September 30, 2008 and that was scheduled to mature before June 30, 2009. This cap is computed on an entity by entity basis (for an institution and for its holding company separately). For debt issued on or before June 30, 2009, the guarantee would extend only for three years, even if the debt has a longer maturity. The ability to tap into this program expires on June 2009. The FDIC will assess a fee equal to 75 basis points of the amount guaranteed under TLGP.

- The Liquidity Guarantee Program *does not* include subordinated debt, and is available only to institutions that had debt outstanding as of September 30, 2008.

The second feature of TLGP provides unlimited insurance coverage for non-interest bearing deposit transaction accounts. These are mainly payment processing accounts such as payroll accounts used by businesses, which frequently exceed the current maximum insurance limit of $250,000. *The non-interest bearing transaction account guarantee ends December 31, 2009.* The FDIC will assess a fee equal to 10 basis points for the amount of non-interest bearing deposits exceeding the $250,000 deposit insurance limit.

Coverage for both parts of the FDIC program will be automatic for eligible institutions for 30 days without charge. After that, institutions will be assessed for the coverage unless they opt out.

The FDIC will maintain control over eligibility in consultation with the institution's primary federal regulator. Institutions that participate in TLGP will be subject to enhanced supervisory oversight to prevent rapid growth or excessive risk-taking.

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For further details regarding the above-described programs, please contact any of the persons listed below.

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