

Client Alert

Economic Crisis Response Group

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U.S. Treasury Department Issues TARP Capital Purchase Program Term Sheet for Private Institutions

On Monday, November 17, 2008, the U.S. Treasury Department (“Treasury”) released its Capital Purchase Program (“CPP”) term sheet for privately held and thinly traded financial institutions and a separate “FAQ sheet” that provides further information about Treasury’s CPP for private banks. The CPP term sheet and FAQs can be found on the Treasury website at <http://www.ustreas.gov/press/releases/hp1277.htm>. This is Treasury’s most recent step in implementing the Troubled Asset Relief Program (“TARP”) that Congress authorized under the Economic Emergency Stabilization Act of 2008 (“EESA”). Under the private bank program, the filing deadline for eligible institutions to apply is December 8, 2008, and the deadline to be approved and to close is January 15, 2009. The application and other relevant documents can be found on the Treasury website at <http://www.treasury.gov/initiatives/eesa/application-documents.shtml>.

Although Treasury’s private bank program was modeled after and, in many respects, tracks the provisions of its previously released term sheet for publicly traded financial institutions, there are several significant differences:

- **“Issuer”.** Under the private bank term sheet, only private financial entities that are not “publicly traded” (other than certain banking entities and holding companies which are treated as Subchapter S corporations and those organized in a mutual form, which are not covered by the new program) can be Qualifying Financial Institutions (“QFIs”) that are eligible to participate in the program. The private bank term sheet defines a QFI to mean any:
 - (i) top-tier Bank Holding Company (“BHC”) or top-tier Savings and Loan Holding Company (“SLHC”) that engages solely or predominantly in activities that are permissible for financial holding companies, which in either case are not publicly traded;
 - (ii) U.S. bank or U.S. savings association organized in a stock form that is neither publicly traded nor controlled by a BHC or SLHC; and

(iii) U.S. bank or U.S. savings association that is not publicly traded and is controlled by an SLHC that is not publicly traded and does not engage solely or predominantly in activities that are permitted for financial holding companies.

Any institution that is controlled by a foreign bank or company is ineligible to participate in Treasury's private bank program.

- ***Economic Terms and Executive Compensation.*** Under the program, a private QFI may sell preferred shares to the Treasury in an amount equal to not less than 1% of its risk-weighted assets and not more than the lesser of (a) 3% of the such assets, and (b) \$25 billion. The terms relating to dividends and rankings, as well as those which impose limitations on executive compensation, are substantially similar to those imposed by the Treasury with respect to its purchase of preferred interests from publicly traded financial institutions (see http://www.proskauer.com/news_publications/client_alerts/content/2008_10_21_b). Highlighted in this Alert are the significant differences between the two programs.
- ***Transferability.*** Under the private bank term sheet, Treasury and its transferees may not effect a transfer of a QFI's preferred shares that would require the QFI to become subject to the Securities and Exchange Commission's ("SEC") periodic reporting requirements. Inclusion of this provision in Treasury's term sheet for public companies was unnecessary because those institutions already are required to file periodic reports with the SEC. Pursuant to the private bank term sheet, if a QFI later becomes subject to the SEC's reporting requirements, it must promptly file a shelf registration statement covering preferred shares that it has issued to Treasury and, if necessary, take steps to have the shelf registration statement declared effective as soon as possible. Moreover, Treasury and its transferees will have "piggyback" registration rights for preferred shares issued by a QFI that later becomes subject to the SEC's reporting requirements.
- ***Exemption to Warrant Requirement.*** Section 113(d)(1) of EESA requires a publicly traded financial institution that participates in the TARP to issue Treasury a warrant to receive either non-voting common or preferred stock or, in the case of a non-publicly traded financial institution, a warrant or senior debt instrument. The warrant must provide for Treasury's reasonable participation in equity appreciation or a reasonable interest premium. In its FAQ sheet, Treasury announced that it is invoking its authority under Section 113(d)(3) of EESA to exempt QFIs from the warrant requirement if the size of the investment is \$50 million or less and the QFI is a certified Community Development Financial Institution ("CDFI"). In its FAQ sheet, Treasury describes a CDFI as a specialized financial institution that works in niche markets that are underserved by traditional financial institutions. (Information about becoming a CDFI is available at <http://www.cdfifund.gov/>.)

To qualify for this exemption, QFIs must apply for certification as a CDFI by December 8, 2008; in other words, a QFI must have a completed CDFI certification application at the time the QFI files its CPP application. If a QFI applies for CDFI

certification, and is eligible to participate in the CPP, it will receive conditional approval, which will be contingent on the QFI receiving the CDFI certification. CDFI certification must be approved by January 15, 2009. According to Treasury, the CDFI Fund has pledged to streamline the certification process to 30 days to allow applicants to qualify for this exemption.

- ***Bank or Thrift Holding Companies.*** In its FAQ sheet, Treasury provides guidance for those financial institutions that have bank or thrift holding company applications pending with a federal regulator. According to Treasury, these institutions may apply for TARP funding through their federal banking regulator on a conditional basis by the December 8, 2008 application deadline. To qualify for TARP, an applicant must apply for approval to become a bank or thrift holding company through ownership of an U.S. bank or savings association that was in existence as of December 8, 2008. Final approval of a holding company application must be granted by January 15, 2009. Moreover, a bank or thrift holding company that receives TARP funding must maintain its status as such for as long as Treasury holds preferred stock and/or warrants in the company. A bank or thrift holding company that decides to terminate its status as such must redeem all preferred stock and warrants held by Treasury prior to the termination.
- ***Dividend and Repurchase Restrictions.*** The private bank term sheet places certain restrictions on dividend and securities repurchases that were not included in Treasury's term sheet for publicly traded institutions. Specifically, the private bank term sheet provides that after the tenth anniversary of an investment by Treasury, a QFI will be prohibited from paying common dividends or repurchasing any equity securities or trust preferred securities until all equity securities held by Treasury have been redeemed in whole, or until Treasury has transferred all of such equity securities to third parties.
- ***Related person transactions.*** The private bank term sheet also includes a provision restricting certain related person transactions. Pursuant to this provision, a QFI (and its subsidiaries) may not enter into transactions with "related persons" (as defined in Item 404 under Regulation S-K promulgated by the SEC) unless the QFI can establish that such transactions (i) are on terms no less favorable to the QFI than could be obtained from an unaffiliated third party, and (ii) have been approved by independent directors of the QFI. Inclusion of this provision in Treasury's term sheet for public companies was unnecessary because public institutions are required to disclose such transactions under the SEC's periodic reporting requirements, which are not applicable to privately held institutions.

The government said that it supplied \$33.56 billion to 21 publicly traded banks in the prior round of capital injections, which closed on November 14, 2008, and it is expected that this round could see applications from a large group out of as many as 3,800 companies.

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