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Katten Muchin Rosenman LLP

Client Advisory

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U.S. Banks and Thrifts Offered Billions of Federal Funds Under Treasury's Capital Purchase Program

The United States Treasury yesterday took bold action to make billions of dollars available to banks and thrifts that want or need to bolster their capital ratios. Nine of the nation's largest financial institutions, even though they are healthy, already have agreed to participate in this program on the same terms that will be available to other banks and thrifts across the nation. The new TARP Capital Purchase Program is available to all U.S. controlled banks, savings associations, and certain other bank and savings and loan holding companies engaged only in permitted financial activities (each, a Qualified Financial Institution or QFI). It is expected that even well-capitalized banks and thrifts will participate in the program if they believe that their capital ratios are or may be threatened in the future. The decision to participate must be made before 5:00 pm (EDT) on November 14, 2008, and Treasury will determine eligibility and allocations for each QFI after consultation with such institution's federal regulator. The following is a summary of some of the more noteworthy terms of the program as described in the Treasury Department's term sheet available at http://www.treas.gov/press/releases/reports/document5hp1207.pdf.

Program Terms

- The capital will be available in the form of senior preferred shares (Senior Preferred) that will be issued by each QFI to the Treasury in exchange for cash.
- The Senior Preferred will count as Tier 1 capital and will rank senior to common stock and pari passu with existing preferred shares, other than preferred shares which by their terms rank junior to existing preferred shares.
- The Senior Preferred will have a cumulative dividend rate of 5% for five years, and a rate of 9% thereafter. Dividends on Senior Preferred issued by banks which are not subsidiaries of holding companies will be payable at the same rates but will be non-cumulative.
- Sales of the Senior Preferred are expected to be complete by December 31, 2008, so participating institutions will be able to add the capital to their balance sheets by the end of the year.
- The Senior Preferred will be non-voting (except for extraordinary matters such as mergers) and are callable after three years.
- The Senior Preferred are generally not redeemable for three years. Issuing QFIs, however, may redeem the shares prior to the end of three years with the proceeds from an offering of any Tier 1 perpetual preferred or common stock which results in aggregate gross proceeds to the institution of not less than 25% of the issue price of the Senior Preferred. For example, a QFI could receive $40 million in new capital from the government, and redeem the Senior Preferred at any time as long as it raises at least $10 million. Or, it could wait for three years and then redeem the Senior Preferred (assuming it has the capacity to do so).
- The Senior Preferred may be transferred by the Treasury.
- 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.

For more information about the TARP Capital Purchase Program, contact one of the members of Katten's TARP Task Force listed below:

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- If the QFI meets its dividend obligations with respect to the Senior Preferred, it will be allowed to continue dividend payments to common shareholders, and, after three years, to redeem junior securities without obtaining the Treasury's consent.

Warrants

Treasury will also receive warrants to purchase common stock with an aggregate market price equal to 15% of its Senior Preferred investment. The initial exercise price for the warrants will be the market price for the common stock on the date of the Senior Preferred investment, calculated on a 20-trading day trailing average and subject to anti-dilution requirements. The exercise price will be subject to reduction, up to a maximum of 45% of the initial exercise price, if any required shareholder approval is not obtained within specified time periods.

The warrants will have a term of 10 years, and generally are immediately exercisable and fully transferable. However, Treasury will only be able to transfer or exercise half the amount of warrants obtained prior to the earlier of (i) December 31, 2009 or (ii) the date that the QFI raises an amount of new capital at least equal to the issue price of the Senior Preferred. Further, if Treasury exercises the warrants, it will agree not to vote the common stock it receives in connection with that exercise.

Registration Statements

Each QFI will be required to file a shelf registration statement covering the Senior Preferred, the warrants and the common stock underlying the warrants as promptly as practicable after the date of any investment, and if necessary, take all action to cause such shelf registration statements to be declared effective as soon as possible.

Executive Compensation

For the period during which Treasury holds equity issued under this program, QFIs must adopt the standards for executive compensation and corporate governance that were set forth in the Emergency Economic Stabilization Act of 2008 (the Act). In addition, Treasury is expected to issue guidance on those standards and has the authority to require additional executive compensation and corporate governance standards to be implemented by QFIs.

The standards specified under the Act apply to the QFI's "senior executive officers" (i.e., the chief executive officer, chief financial officer and the next three most highly compensated executive officers) and generally include: (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required repayment (or "clawback") provisions for any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on the QFI from making any "golden parachute" payment to a senior executive officer; and (4) no tax deductions for compensation paid to each senior executive officer in excess of $500,000 per year. The prohibition on "golden parachute" payments may require modification of existing contracts and severance arrangements.

Katten's TARP Task Force

Katten Muchin Rosenman LLP's multidisciplinary TARP Task Force advises clients on the U.S. Department of the Treasury's Troubled Asset Relief Program created under the Emergency Economic Stabilization Act of 2008. Katten's TARP Task Force can advise clients on how to structure their participation in the TARP Capital Purchase Program, including preparing and filing the registration statements for the Senior Preferred, the warrants, and the common stock underlying the warrants. We can also help clients determine how the executive compensation rules apply to them and help them structure their compensation arrangements appropriately.

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