

MORRISON

FOERSTER

TARP and Government Intervention in 2009

March 3, 2009

Overview

- Newest Federal Programs
- Alternatives for Financial Institutions
- Future

Financial Stability Plan

- Financial Stability Trust
 - Capital Assistance Program
 - Special Economic Assessments – Stress Tests
 - Disclosure and Transparency Initiative
- Public-Private Investment Trust
- Consumer and Business Lending Initiative
- Transparency and Accountability Agenda
- Homeowner Affordability and Stability Plan
- A Small Business and Community Lending Initiative

Financial Stability Plan and TARP

- Financial Stability Trust
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TARP \$

Financial Stability Trust

- Capital Assistance Program (CAP)
 - Announced February 25
 - Capital investments
 - Mandatory convertible preferred stock
 - Same eligibility requirements as for Capital Purchase Program
 - Capital Purchase Program senior preferred can be exchanged into CAP mandatory convert
 - Capital Purchase Program (CaPP) remains in place
- Disclosure and Transparency Initiatives
 - No details available other than enhanced reporting under CAP
- Special Economic Assessments or “Stress Tests”

Financial Stability Trust

- **Special Economic Assessments**
 - Banking institutions with \$100 billion or more in assets as of Dec 31
 - 19 institutions
 - Will be completed by the end of April 2009
 - Includes base case scenario and “more adverse” scenario
 - Banking regulators will work with management to assess each institution’s ability to withstand the base case and more adverse scenario
 - If additional capital is required to withstand the worse case scenario, institution must enter into a commitment for CAP
 - If private capital cannot be raised within six months, CAP investment will close

Financial Stability Trust

- Special Economic Assessment – Sample Economic Scenarios

	2009	2010
Real GDP Baseline	-2.0	2.1
Real GDP More Adverse	-3.3	0.5
Civilian Unemployment Baseline	8.4	8.8
Civilian Unemployment More Adverse	8.9	10.3
Home Values Baseline	-14	-4
Home Values More Adverse	-22	-7

Financial Stability Trust

- **Special Economic Assessments**
 - Only applies to largest banking institutions
 - “Too big to fail”
 - Moral Hazard Risk: Too big to fail institutions will take more risks
 - Impose stricter standards on these institutions – balance the benefits of being too big to fail

Financial Stability Trust - CAP

- Any publicly-traded eligible institution can apply
- Terms for privately-held institutions, subchapter S corporations and mutual organizations expected
- Deadline for publicly-held institutions is May 25, 2009
- Largest institutions do not need to wait for the assessments to conclude to apply

CAP – Exchange Feature

- Capital Purchase Program investments can only be redeemed with the proceeds from a Qualified Equity Offering
 - Qualified Equity Offering: Tier 1 perpetual preferred or common stock
- CAP amends the Capital Purchase Program – issuance of mandatory converts constitutes a Qualified Equity Offering
- Capital Purchase Program investments can be exchanged for CAP investments
- Only constitutes a Qualified Equity Offering to the extent proceeds are used to redeem Capital Purchase Program securities
- If proceeds are used for redemption, they are counted toward the amount needed to reduce the number shares underlying the Capital Purchase Program warrant
- NOTE: American Recovery and Reinvestment Act of 2009 included a “redeem without limitation” provision that is being implemented – it is subject to bank regulatory consultation

CAP – Application

- Amount available:
 - No less than 1% of risk-weighted assets may be requested
 - No more than:
 - 2% of risk weighted assets PLUS
 - Amount of Capital Purchase Program securities being redeemed PLUS
 - Amount of Targeted Investment Program securities being redeemed
- Extra amounts constitute “exceptional assistance” – subject to enhanced executive compensation and governance limitations to be negotiated directly with Treasury
- Application: must include plans for lending – what will be done that couldn’t have been done without additional capital
- Reporting: Monthly lending reports will be made public

CAP - Eligibility

- US institutions only
 - Banks and savings associations
 - Top tier BHCs
 - Top tier S&LHCs – engaging exclusively in activities permissible for financial holding companies (financial activities)

Mandatory Convertible Preferred Terms

- Tier 1 capital for holding companies
- Senior to common stock and *pari passu* with existing preferred stock other than jr. pfd stock
- Liquidation preference of \$1,000 per share (or depositary issues depositary receipts)
- Convertible at 90% of avg. closing price for the 20-trading day period ending Feb 9, 2009
- Conversion price is subject to reduction (15% each 6-mos, up to 45%) if any required shareholder approval is not obtained
- Upon conversion, accrued and unpaid dividends are payable in cash or common stock, at the election of the institution
- Mandatorily converts after 7 years, and earlier at the issuer's option, (w/ primary federal banking regulator approval)

Mandatory Convertible Preferred Terms

- Treasury can convert upon merger, sales, change in control, etc.
- 9% annual dividend, compounding quarterly; 20% as long as any required s/h approval not obtained after 6-mos
- Redemption:
 - Consent of primary federal banking regulator with proceeds of a cash sale of common stock (gross proceeds at least 25%)
 - First two years: at par plus accrued and unpaid dividends
 - After the first two years, at the greater of par plus accrued and unpaid dividends and the as-converted value
 - After conversion with cash proceeds of common stock sale or additions to retained earnings (price: greater of conversion price and 20-day average beginning after notice of repurchase)
- Upon redemption in full, institution can redeem outstanding warrants and any common stock held by Treasury at FMV

Warrant Terms

- Warrant to purchase a number of shares of common stock having an aggregate market value equal to 20% of the mandatory convertible preferred amount on the date of investment
- Exercise price for the warrant and market price for determining number of shares of common stock underlying the warrant will be 90% of the average closing price for the 20-trading day period ending February 9, 2009
- Term of 10 years
- Immediately exercisable

Warrant Terms

- Treasury will agree not to exercise voting control with respect to any shares of common stock received upon exercise of the warrant
- If the common stock is no longer listed or traded on a national securities exchange, or any required shareholder consent is not obtained within 18 months of the closing date, the warrant will be exchangeable at the option of Treasury into senior debt or another instrument
- Following repurchase in full of the mandatory convertible preferred and/or common stock, institution can repurchase the warrant and any related common stock at fair market value

CAP Corporate Limitations

- Failure to pay dividend: No dividends on more junior securities, no share repurchases
- Consent required for share repurchases (subject to the same exceptions as in Capital Purchase Program) – includes equity and trust preferred
- Dividend on common stock cannot exceed \$0.01, unless Treasury consents
- Voting
 - Pre-conversion: limited to authorization or issuance of senior ranking shares, amendment to rights of mandatory convertible preferred or merger, exchange or similar transaction that would adversely affect the mandatory convertible preferred
 - Following conversion: voting rights as a holder of common stock
- Treasury to Elect 2 Directors
 - Dividends not paid for any 6 periods: Treasury to elect 2 directors
 - After dividends paid in full and then paid in full for four consecutive periods, Treasury loses right
- Transferability:
 - File shelf registration statement for the mandatory convertible preferred, warrant and underlying common stock
 - Agree to all other reasonable efforts, including: grant of piggyback registration rights, listing securities on a national securities exchange or appointment of a depository to hold shares and issue depository receipts

CAP – Executive Compensation

- CAP participants, as TARP recipients, are subject to the Emergency Economic Stabilization Act executive compensation and corporate governance rules
- These were amended in the stimulus plan (American Recovery and Reinvestment Act of 2009)
- Amendments are **retroactive** – as a result, there is no executive compensation benefit to avoiding participation in Treasury programs funded with TARP – like CAP
- Implementation detail generally won't be available until Treasury publishes regulations
 - One exception: Say-on-Pay applies to the current proxy season

Amended Executive Compensation Rules

- **No Bonus Rule**
 - Who is impacted depends on amount of money received
 - Bonus limited to restricted stock equal 1/3 annual compensation, may not fully vest prior to termination of Treasury ownership

Funds Received	Employees Subject to Restriction
< \$25,000,000	The most highly compensated employee
≥ \$25,000,000, but < \$250,000,000	The 5 most highly compensated employees, or such higher number as Treasury shall determine is in the public interest
≥ \$250,000,000 but < \$500,000,000	The senior executive officers and at least the next 10 most highly compensated employees or such higher number as Treasury shall determine is in the public interest
\$500,000,000 or more	The senior executive officers and at least the next 20 most highly compensated employees or such higher number as Treasury shall determine is in the public interest

Executive Compensation

- Golden Parachute redefined:
 - Now “any payment”
 - Senior Executive Officers and now next top 5 highly compensated
 - Now any departure (no longer involuntary termination or institution failure)
- Certifications
 - CEO certifications extended to include CFO
 - Certifications for public companies must be made to SEC, all others continue to go to Treasury
- Committee
 - Statute mandates the board must form a Compensation Committee comprised of exclusively independent members
 - Only institutions receiving less than \$25 million from TARP are exempt – but those institutions must have Board take action, cannot be delegated
 - Must meet twice per year

Luxury Payments

- Board must approve a policy addressing luxury and excessive payments
- Identifies matters board should consider addressing:
 - Entertainment or events;
 - Office and facility renovations;
 - Aviation or other transportation services; and
 - Other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives or other similar measures conducted in the normal course of business operations.

Say-on-Pay

- Institution must hold non-binding shareholder vote
- Shareholders must vote on the compensation disclosure provided under SEC rules
- Senator Dodd sent a letter to Chairman Shapiro:
 - Law applies immediately upon enactment; rulemaking not necessary
 - SEC agreed, and issued a Compliance and Disclosure Interpretation
- Inclusion in proxy of shareholder proposals may not be sufficient – shareholder vote must expressly address the compensation disclosed in the current proxy
- Vote required at annual meeting to elect directors (not at other shareholder meetings)
- SEC indicated statute does not impose a higher duty to disclose on smaller institutions

Temporary Liquidity Guarantee Program

- FDIC's Debt Guarantee Program under the TLGP
 - Announced October 14, 2008
 - Tens of billions of dollars of debt guaranteed by the FDIC
 - FDIC guaranteed timely payment of principal and interest
 - Qualifying senior unsecured debt issued under an issuance cap
 - Eligible institutions made elections on December 5, 2008 – no ability to change elections
 - Extensions:
 - Announced plan to extend to include collateralized debt – No action
 - Announced plan to extend issuance date through October – No action
 - Plan to extend to mandatory convertible debt – February 27, 2009
 - Interim Final Rules subject to 15 day comment period after publication

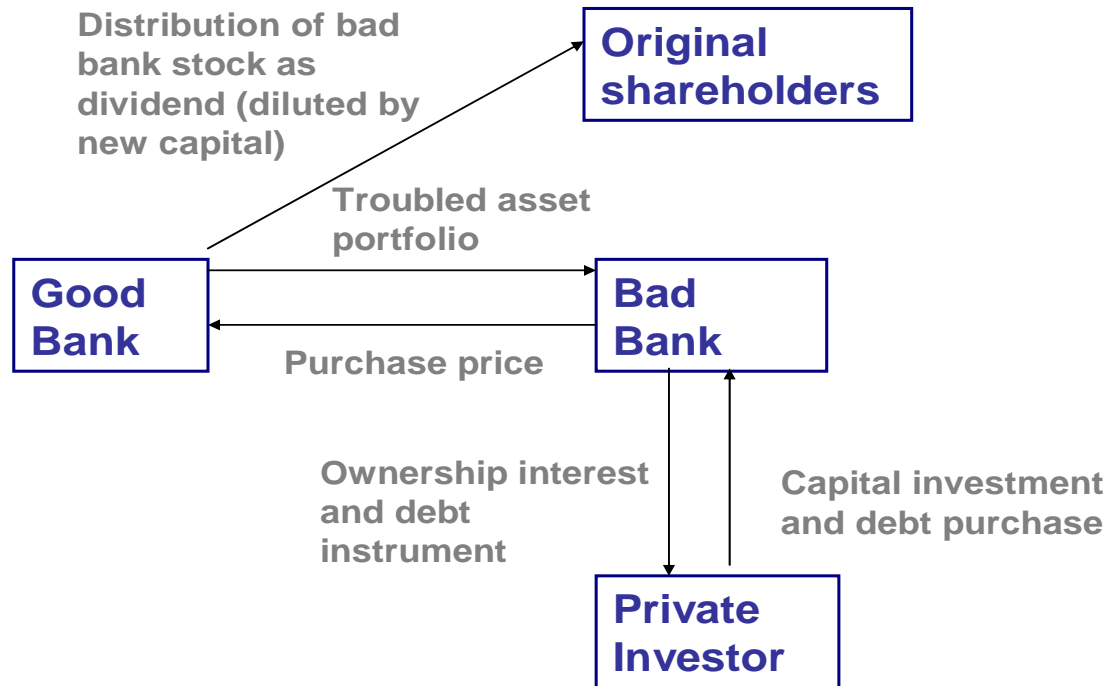
TLGP Amendment

- **Mandatory Convertible Debt**
 - Now within definition of “senior unsecured debt” in rule
 - No increase in issuance cap (remains 125% of debt outstanding on September 30, 2008 that was scheduled to mature on June 30, 2009)
 - No clear extension of the issuance date
 - Currently last date to issue is June 30, 2009
 - Application to issue mandatory convertible debt must be received by June 30, 2009
 - Implies issuance can be after that date
 - Interim Final Rule provides additional disclosure to clarify guarantee expires on the earlier to occur of the conversion date or June 30, 2012

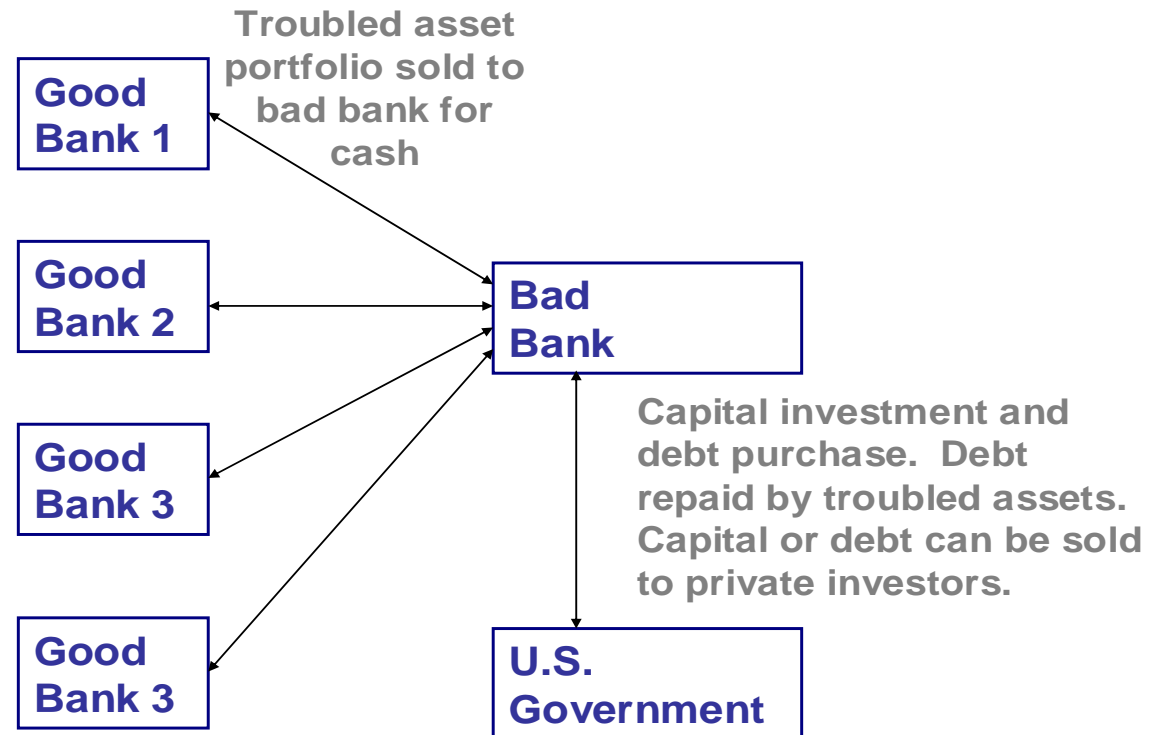
Alternatives

- Good Bank – Bad Bank
 - Private Good Bank-Bad Bank
 - Liquidation bad bank (Mellon)
 - Segregate limited businesses into bad bank (Citi)
 - Government Sponsored Good Bank-Bad Bank
 - Provide capital and lending to bad bank
 - Provide capital to good bank (shareholders bear burden of bad bank)
- Aggregator Bank
- Insurance Alternatives

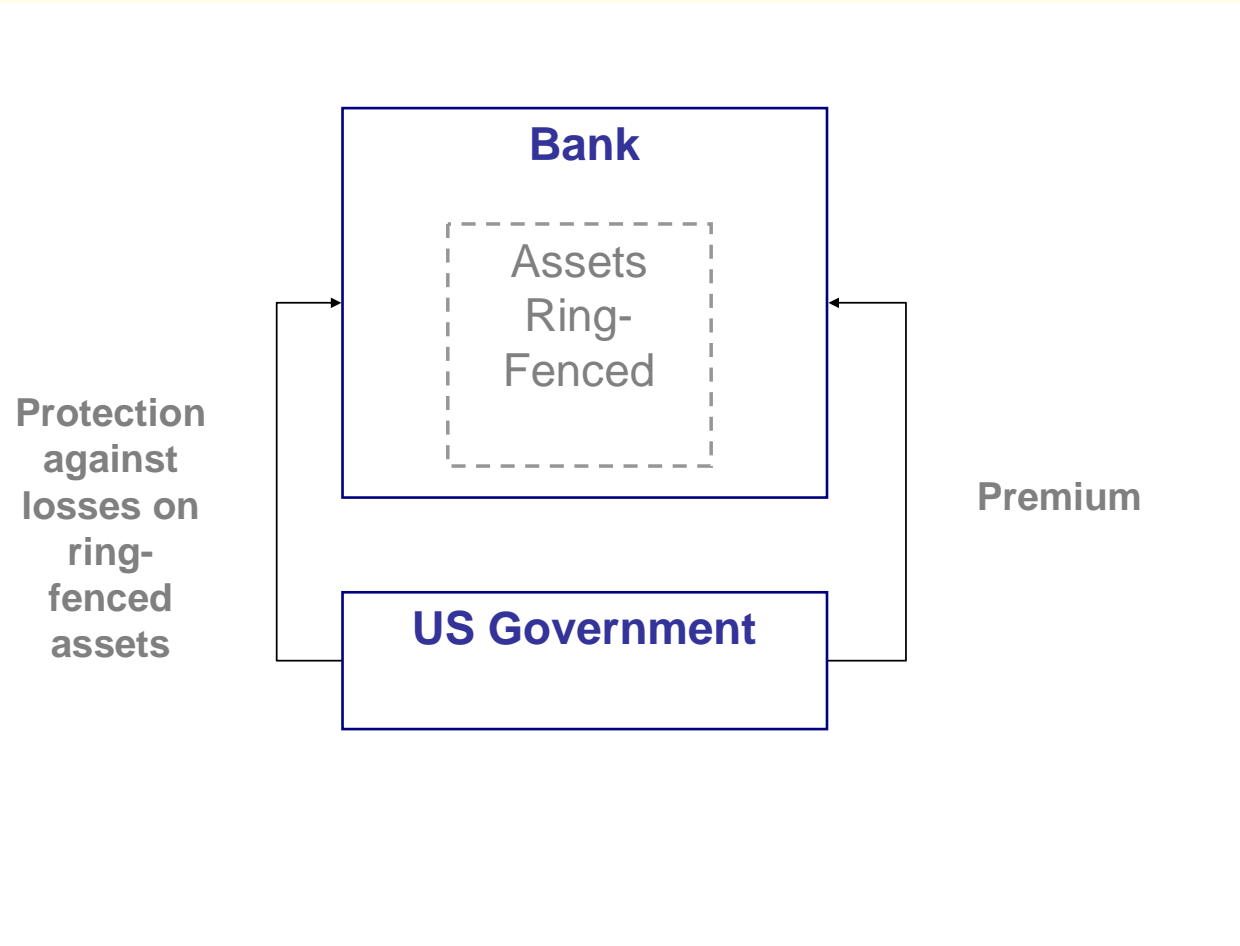
Good Bank / Bad Bank



Aggregator Bad Bank



Insurance or Guarantee Alternative



Future of Federal Recovery Efforts

