manatt

October 15, 2008

BANKING LAW @MANATT

NEWSLETTER OF THE **BANKING AND SPECIALTY FINANCE** PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

Manatt's Banking Group is working closely with our Government Affairs Group in Washington, DC, to provide you with answers to key questions you may have regarding the legislation, regulations, and guidance surrounding the TARP and related programs created by the economic rescue legislation. There is a strong likelihood that these matters will play a very important role in reshaping the banking world as we have come to know it, both in the short term and, more importantly, in reform efforts that may be implemented under the new administration and Congress in January. We invite you to contact us with any questions you may have. In the meantime, we will continue to keep you updated as new developments occur.

The coordinated announcement today from Treasury, the Federal Reserve and the FDIC has generally been applauded in financial circles. However, there remain a number of questions that remain unanswered and which presumably will be addressed by the responsible authorities in the short term. Nevertheless, it is important for banks and their advisors to understand some of the basic principles being initiated so that informed decisions for the long term can be made by each concerned institution and its executives and directors.

In conjunction with the Emergency Economic Stabilization Act ("EESA"), the United States Treasury Department (the "Treasury") has announced a voluntary Capital Purchase Program (the "Capital Purchase Program") to assist financial institutions and increase lending to United States businesses and consumers. Pursuant to the program, the Treasury will purchase up to $250 billion of senior preferred stock from qualifying institutions. The following summarizes the major provisions of the program and raises questions which will have to be answered by the federal government in the coming days ahead.

IN THIS ISSUE

NEWSLETTER EDITORS

Katerina Hertzog Bohannon
Partner
kbohannon@manatt.com
650.812.1364

Harold P. Reichwald
Partner
hreichwald@manatt.com
310.312.4148

OUR PRACTICE

Manatt was founded with a special emphasis on advising banking and financial services clients. Today we are one of the leading banking law firms in the United States, representing numerous banks, holding companies, foreign banks, savings institutions, mortgage lenders, finance lenders, credit card issuers, acquirers and processors and industrial loan companies ... more

. Practice Group Overview
. Practice Group Members

Manatt's Government & Regulatory professionals draw on extensive knowledge, experience and contacts to achieve our client's goals. Through its offices in Washington, D.C., Los Angeles, New York City, Sacramento and Albany, Manatt is able to provide an unparalleled breadth of public policy and advocacy services. Our substantive understanding of regulated industries and interrelationships with ... more

. Practice Group Overview
. Practice Group Members

INFO & RESOURCES

. Subscribe
. Unsubscribe
. Sarbanes-Oxley Act
. Newsletter Disclaimer
. Technical Support
. Manatt.com

Capital Purchase Program

Craig D. Miller
Renee E. Becker
Barbara S. Polsky

Who is eligible to participate in Capital Purchase Program?

Qualifying financial institutions ("QFI") are eligible to participate. QFI's are generally any (i) United States bank or savings association which is not controlled by a holding company or (ii) any United States bank or savings association holding company which is engaged only in activities permissible for financial holding companies. Although we believe most United States institutions will be eligible to participate in the Capital Purchase Program, the ability of smaller institutions, private institutions, and institutions with informal or formal regulatory orders pending will have to be addressed directly by Treasury. Any financial institution which is interested in participating in the Capital Purchase Program should promptly contact its primary federal regulator to determine its eligibility.

What type of securities will the QFI be required to issue?

The QFI will be required to issue senior preferred stock ("Senior Preferred") and warrants with the following basic terms:

Senior Preferred - The Senior Preferred will be perpetual and will have a liquidation preference of $1,000 per share. The Senior Preferred will rank senior to common stock and pari passu with existing preferred shares other than preferred shares which by their terms rank junior to any existing preferred shares.

Warrants - The warrants will be immediately exercisable over a period of 10 years, and will give the holder the right to purchase the number of shares of common stock of the QFI having an aggregate market price equal to 15% of the Senior Preferred amount on the date of the Treasury's investment, subject to reduction in the event the QFI issues additional equity securities on or prior to December 31, 2009. The Treasury will agree not to exercise voting power with respect to any shares of common stock of the QFI issued to it upon the exercise of the warrants.

Who will hold the securities issued by the QFI?

The Treasury will be the initial holder of the securities issued by the QFI.

Will the securities trade on any exchange or quotation system?

If requested by the Treasury, the QFI will use reasonable efforts to list the Senior Preferred on a national securities exchange or to have the Senior Preferred quoted on a quotation system.

What are the limitations on the amount of capital which can be raised through the Capital Purchase Program?

Each QFI may issue an amount of Senior Preferred equal to not less than 1% of its risk-weighted assets and not more than the lesser of (i) $25 billion and (ii) 3% of its risk-weighted assets.

What capital treatment will be accorded the Senior Preferred?

The Senior Preferred will be accorded Tier 1 capital treatment.

What dividend rate will be paid on the Senior Preferred?

The Senior Preferred will pay cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per annum. For Senior Preferred issued by banks which are not subsidiaries of holding companies, the Senior Preferred will pay non-cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per
annum.

What if the QFI misses a dividend payment?

If dividends on the Senior Preferred are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

Is the Senior Preferred redeemable?

Senior Preferred may not be redeemed for a period of three years from the date of the Treasury's investment, except with the proceeds from a Qualified Equity Offering (as defined below) which results in aggregate gross proceeds to the QFI of not less than 25% of the issue price of the Senior Preferred.

After the third anniversary of the date of the Treasury's investment, the Senior Preferred may be redeemed, in whole or in part, at any time and from time to time, at the option of the QFI. All redemptions of the Senior Preferred shall be at 100% of its issue price, plus (i) in the case of cumulative Senior Preferred, any accrued and unpaid dividends and (ii) in the case of noncumulative Senior Preferred, accrued and unpaid dividends for the then current dividend period (regardless of whether any dividends are actually declared for such dividend period), and shall be subject to the approval of the QFI's primary federal bank regulator.

"Qualified Equity Offering" shall mean the sale by the QFI after the date of the Treasury's investment of Tier 1 qualifying perpetual preferred stock or common stock for cash.

Are there any restrictions imposed on the QFI once it issues the Senior Preferred?

Restrictions on Dividends: For as long as any Senior Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Senior Preferred), nor may the QFI repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Senior Preferred or common shares, unless (i) in the case of cumulative Senior Preferred, all accrued and unpaid dividends for all past dividend periods on the Senior Preferred are fully paid or (ii) in the case of non-cumulative Senior Preferred, the full dividend for the latest completed dividend period has been declared and paid in full.

Consent for Common Dividends: The Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred is redeemed in whole or the Treasury has transferred all of the

Senior Preferred to third parties.

Will the Senior Preferred have voting rights?

The Senior Preferred will be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Senior Preferred, (ii) any amendment to the rights of Senior Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Senior Preferred. If dividends on the Senior Preferred are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

Will the Senior Preferred be transferable?

The Senior Preferred will not be subject to any contractual restrictions on transfer. The QFI must take all steps reasonably requested by the Treasury to facilitate the transfer of the Senior Preferred, including, if requested by the Treasury, using reasonable efforts to list the Senior Preferred on a national securities exchange.

Will the Senior Preferred have registration rights?

Yes. The QFI will be required to file a shelf registration statement covering the Senior Preferred as promptly as practicable after the date of the Treasury's investment and, if necessary, to take all action required to cause such shelf registration statement to be declared effective as soon as possible after the date of filing. The QFI will also grant to the Treasury piggyback registration rights for the Senior Preferred with respect to offerings registered by the QFI.

What if the financial institution seeking to participate in the Capital Purchase Program is currently unable to pay dividends?

The program leaves this important question current unanswered. We are hopeful that guidance will be issued in the near future to address this issue for the most troubled institutions in need of capital.

What if the financial institutions seeking to participate in the Capital Purchase Program is not a publicly traded financial institution?

The program addresses issues tied to publicly traded financial institutions (such as registration rights and free transferability), but does not address how nonpublic institutions will be able to avail themselves of the Capital Purchase Program.

What if the charter documents of the financial institution seeking to participate do not authorize preferred stock?

If the charter documents of the financial institution seeking to participate do not currently authorize preferred stock, the charter documents will need to be amended. Under California law, amendments to a corporation's articles of incorporation to authorize the issuance of preferred stock generally requires the approval of a majority of the outstanding shares entitled to vote.

What if the charter documents of a QFI do not authorize sufficient shares of common stock to permit the exercise of the warrant or the applicable rules of the stock exchange or quotation system on which a QFI's securities are listed require stockholder approval before the warrant can be issued?

As set forth above, the charter documents would need to be amended prior to the exercise of the warrant and/or the financial institution seeking to participate would be required to obtain a waiver from the applicable exchange prior to issuing the warrant.

What is the role of a QFI's primary state regulator in the Capital Purchase Program?

The role of the primary state regulator is left unanswered. Indeed, many financial institutions seeking to participate may be prohibited by their state regulator from issuing dividends or any capital securities without prior regulatory approval, and many state regulators, like the California Department of Financial Institutions, require a permit prior to the issuance of any securities. Coordination between the state and federal regulators will have to be harmonized before the Capital Purchase Program will be able to be effectively administered for certain financial institutions.

back to top

Restrictions on Executive Compensation

John J. Heber

Ellen Marshall

The Treasury Department has placed certain tax disincentives on amounts paid to executives of institutions that participate in the programs available under the Act. The disincentives that apply will depend on which program the institution is participating in. The following summarizes the general policies of the regulations to be released with respect to the programs available under the Act:

Troubled Asset Auction Program

The Act prescribes that any financial institution that sells more than $300 million of troubled assets to the Treasury via an auction would be subject to the following executive compensation regulation:

- No "new" executive contracts may be entered into that include golden parachute payments for the term of the program
- The financial institution may not deduct executive compensation per individual in excess of $500,000
- The financial institution may not deduct certain golden parachute payments to its senior executives
- A 20 percent excise tax will be imposed on the senior executive for these golden parachute payments

Treasury is releasing detailed guidance under Treasury Notice 2008-TAAP and IRS Notice 2008-94 on these executive compensation regulations.

Capital Purchase Program

Financial institutions participating in the Capital Purchase Program will be subject to the following executive compensation regulations during the period Treasury holds the purchased equity:

- Incentive compensation programs must not encourage excessive risks that threaten the financial health of the institution
- Bonuses and incentive pay that were based on financial statements that were materially inaccurate must subject to clawback provisions
- The financial institution is prohibited from making golden parachute payments to senior executives

- The financial institution may not deduct executive compensation per individual in excess of $500,000

Programs for Systemically Significant Failing Institutions

Treasury is currently developing a third program to potentially provide direct assistance to certain failing firms on terms negotiated on a case-by-case basis. Treasury is issuance guidance under Treasury notice 2008-PSSFI for the executive compensation regulations that apply to institutions participating in this programs. These regulations are expected to be similar to those that apply under the Capital Purchase Program, with the exception of more enhanced restrictions on golden parachute payments to departing senior executives.

back to top

Temporary Liquidity Guarantee Program

Charles Washburn, Jr.
Gene R. Elerding

In coordination with efforts by the U.S. Treasury and the Federal Reserve Board to enhance confidence in U.S. financial institutions, the Federal Deposit Insurance Corporation (the "FDIC") on October 14 announced its Temporary Liquidity Guarantee Program (the "TLGP").

What is the TLGP?

The TLGP is a program intended by the FDIC to unlock frozen inter-bank lending and bolster liquidity. It has two main elements:

- The FDIC will guarantee new senior unsecured debt issued by eligible banks, thrifts and their holding companies.

- The FDIC will provide unlimited insurance coverage for non-interest bearing deposit transaction accounts.

The FDIC noted that European and Asian governments have provided similar guarantees for bank debt and increases in deposit insurance coverage, and the FDIC initiative levels the playing field for U.S. institutions.

What institutions are eligible to participate in the TLGP?

Eligible institutions include FDIC-insured depository institutions, U.S. bank holding companies, U.S. financial holding companies ("FHCs"), and U.S. savings and loan holding companies ("SLHCs") that engage only in activities permissible for FHCs. Accordingly, a pre–GLBA "grandfathered" SLHC that engages in non–FHC activities would not be eligible.

What debt is covered by the guarantee?

The FDIC guarantee will apply to all newly issued senior unsecured debt that is issued by eligible institutions until June 30, 2009. Covered debts include inter-bank funding, commercial paper, promissory notes and the unsecured portion of secured debt. Maturing senior debt can be rolled into new, FDIC guaranteed debt.

Is there any cap on how much debt can be covered by the guarantee?

The total amount of an eligible institution's debt covered by the guarantee may not exceed 125% of the debt that was outstanding as of September 30, 2008 and was scheduled to mature before June 30, 2009. The FDIC believes that up to $1.4 trillion in debt may be eligible under the program.

How long does the guarantee last?

Eligible debt issued on or before June 30, 2009 is guaranteed for up to three years beyond that date (that is, until June 30, 2012). Note that covered debt that matures after June 30, 2012 will lose the guarantee at that time. Only payments on debt that are due prior to that date are guaranteed.

What accounts are covered by the unlimited deposit insurance?

The unlimited deposit insurance coverage applies to funds in non–interest bearing transaction accounts held by FDIC–insured institutions. The FDIC believes that $400-500 billion in deposits may be covered.

How long does the unlimited insurance coverage last?

The unlimited insurance extends until December 31, 2009. This is the same date the higher $250,000 coverage limit for other types of accounts is set to expire.

Why was deposit insurance increased for transaction

accounts?

Deposit insurance for all accounts recently has been increased to $250,000. However, businesses often keep larger amounts in transaction accounts to meet payroll and other expenses, and some businesses were withdrawing these funds from smaller institutions, which were perceived as at risk based on their size. Providing unlimited insurance for consumer and business transaction accounts is intended to eliminate this concern and hopefully stem the flow of deposits out of these smaller but healthy institutions.

What will it cost?

The FDIC stressed that the TLGP will not involve taxpayer funds. Instead, fees will be imposed on participating institutions. Fees are waived for all institutions for the first 30 days. Thereafter, the following fees will be imposed:

- An annualized fee equal to 75 basis points multiplied by the amount of the debt will be charged for debt guaranteed under the TLGP.
- A surcharge equal to 10 basis points will be applied to non-interest bearing transaction deposit accounts not covered by existing deposit insurance of $250,000, which surcharge will be added to the institution's deposit insurance premiums.

These fees will be held in a separate account by the FDIC to be used only for the costs incurred by the TLGP. If the program costs exceed the amount of the collected fees, the difference will be made up with a special assessment on the banking industry (including institutions that have opted out of the TLGP).

Are all financial institutions and holding companies required to participate?

No, the program is voluntary. However, all FDIC-insured institutions are automatically covered for the first 30 calendar days of the program (and at no cost as discussed above). During this 30 day period, institutions that do not wish to continue to participate must "opt out" or be assessed for future participation. Opting-out is not permitted after the 30 day period. Guarantees of the debt of opting out institutions that was issued during the initial 30 days will expire at the end of that period. An institution may opt out of either or both of the elements of the TLGP.

What kind of supervisory oversight is expected for institutions that remain in the program?

Rules involving supervisory oversight will be issued in the near future to prevent rapid growth and excessive risk-taking. Eligibility for the programs will be determined by the FDIC in consultation with an institution's primary federal regulator.

back to top

Systemically Significant Failing Institutions

Harold P. Reichwald

Amidst the detailed pronouncements issued on a coordinated basis by the Treasury, the Federal Reserve and the FDIC, the Treasury also announced that it was developing a third program to provide direct assistance "to certain failing firms" on terms which would be negotiated on a case-by-case basis. The announcement did not clearly state whether this was intended to include investment banks as well as commercial banks and thrifts but given the coordinated actions over the last several weeks, it must be assume that the program is being designed to cover all these types of institutions.

The Treasury went out of its way in today's announcement to make clear that the executive compensation standards announced for the Capital Purchase Program will apply with significantly enhanced provisions prohibiting any payments to departing senior executives. In this respect, it appears that the Treasury will follow the strictures contained in the Federal Deposit Insurance Act relating to the golden parachute payments.

The announcement did not indicate how the Treasury intends to define a "systemically significant failing institution" nor how this separate program is intended to be implemented or managed. However, the words seem to indicate that an institution eligible for this kind of assistance would have to be declared to be of such significance to the overall financial system that its failure would pose a significant widespread threat. This may be a codification of the oft-repeated concept of "too big to fail."

back to top

Commercial Paper Funding Facility (CPFF)

Harold P. Reichwald

The Federal Reserve announced that commencing October 27, 2008, it will provide a liquidity backstop for U.S. issuers of commercial paper. This program is designed to improve liquidity in the short-term funding markets with the expectation that this will free up the availability of credit for businesses and consumers.

How will this program work?

The Federal Reserve Bank of New York will manage this backstop facility for dollar denominated three month, non-extendable commercial paper, utilizing a special purpose vehicle created for this purpose which will purchase commercial paper that is A-1/P-1/F-1 rated. The limit for each issuer will the highest amount of commercial paper that the issuer had outstanding during this year up to the end of August. The program will end on April 30, 2009. A special purpose vehicle (SPV) is being created for this activity.

Are there special requirements for an Issuer?

The issuer of the commercial paper must be U.S.-based but that also will include issuers with a foreign parent. However, to be eligible, an issuer will have to register once with the CPFF at the New York Federal Reserve Bank and pay a facility fee of 10 basis points on the maximum amount to be covered. Registration begins on October 20, 2008 for the commencement of the CPFF on October 27, 2008.

What will the pricing be for this CPFF?

Pricing will be based on the then-current three-month overnight index swap plus fixed spreads depending upon whether the commercial paper is unsecured (100 b.p.) or asset-backed (300 b.p.).

How will the special purpose vehicle be funded and managed?

The SPV will be funded by loans from the New York Federal Reserve Bank, which will be with full recourse to the SPV and secured by the assets of the SPV. PIMCO will serve as asset manager and State Street Bank and Trust will be the custodian and administrator.

back to top