21st Century Money, Banking & Commerce Alert®

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TARP Takes a New Turn; FDIC Takes On a New Role

I. Treasury's Preferred Stock Purchase Program

The Treasury Department has decided that its first exercise of its authority under the Emergency Economic Stabilization Act ("Act") will be to purchase up to $250 billion in preferred stock in the nation's financial institutions under a Preferred Stock Purchase Program ("Program"). Reports indicate that the initial purchases will be in nine of the nation's largest financial services firms.

When the Congress considered the Act, it focused on the use of the $700 billion that could be made available to the Treasury to purchase troubled mortgage related assets. Since the passage of the Act, it appears that the Administration has come to believe that the general unwillingness of financial institutions to lend to one another had overtaken concerns about the impact of problem assets on the books of particular institutions. As a result, Treasury appears to have concluded that it could act more quickly, with greater impact, and with a potentially less destabilizing impact by directly investing in key financial institutions.

Treasury Secretary Paulson said that while having the government own a stake in a private company was objectionable to him, the alternative of leaving businesses and consumers without access to credit was totally unacceptable.

1.1. Eligible Institutions

The Program provides a partial answer to the question of how broadly the Treasury will construe the term "financial institution" as used in the Act. As noted in our October 6, 2008, Alert, "*Emergency Economic Stabilization Act Offers Opportunities for Sellers, Contractors and Purchasers*," the Act purports to allow the Treasury to treat an extremely broad range of entities as financial institutions from which the Treasury could purchase assets. Under this new Program a more limited group of entities, referred to as Qualifying Financial Institutions ("QFI"), will be eligible to participate.

QFIs will consist of:

- Any US bank or savings institution that is not controlled by a bank holding company ("BHC") or savings and loan holding company ("SLHC").

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- Any US BHC or any US SLHC (which only engages in activities permissible for financial holding companies) and any US bank or US savings association that is controlled by a qualifying BHC or SLHC.
- Any US BHC or SLHC whose US depository institution subsidiaries are the subject of an application under Section 4(c)(8) of the Bank Holding Company Act.
- A QFI does not include any BHC, SLHC, bank or savings association that is controlled by a foreign bank or company.
- It remains to be seen whether the Treasury will decide to limit its purchases of troubled assets under the Troubled Asset Relief Program to institutions that meet the definition of a QFI.

1.2. Key Provisions of the Program

The Treasury term sheet describes the senior preferred stock and warrants that it would propose to purchase from participating QFIs. Key provisions of the term sheet include the following:

Senior Preferred Stock

- A QFI may issue Senior Preferred in an amount not less than 1% of risk weighted assets and not more than the lesser of $25 billion or 3% of risk weighted assets.
- Senior Preferred will be perpetual and senior to common and any junior preferred stock, and *pari passu* with existing preferred stock.
- Senior Preferred will generally pay cumulative dividends at a rate of 5% until the fifth anniversary of issuance, and 9% thereafter.
- Senior Preferred may not be redeemed for three years after issuance except with the proceeds of an offering of perpetual preferred stock or common stock that meets certain requirements ("Qualifying Equity Offering"). After that time, Senior Preferred may be redeemed in whole or in part at the option of the issuer.
- An issuer will generally be prohibited from paying dividends on any other stock or repurchasing any other stock unless all accrued and unpaid dividends on the Senior Preferred have been fully paid.
- While the Senior Preferred remains outstanding, until the third anniversary of its issuance, the issuer must obtain Treasury approval to increase dividends on its common stock. During the same period, Treasury consent will also generally be required for repurchases of other issuer stock.
- Senior Preferred will be non-voting other than for (i) authorization or issuance of shares ranking senior to the Senior Preferred, (ii) any amendment to the rights of the Senior Preferred, or (iii) any corporate transaction that would adversely affect the rights of the Senior Preferred. In the event dividends are not paid in full for six dividend periods, the

Senior Preferred will have the right to elect two directors. That right will end when full dividends have been paid for four consecutive quarters.

- The Senior Preferred will not be subject to any contractual restrictions on transfer and shall be covered by a shelf registration filed by the issuer.

- The QFI and its senior executive officers covered by the Act will be required to modify or terminate all employment related agreements in order to be in compliance with the requirements of section 111 of Act and the Treasury's implementing guidance or regulations. In addition the QFI must agree to comply with the executive compensation and corporate governance standards of section 111 of the Act and the Treasury's implementing guidance or regulations. These restrictions will apply as long as the Treasury holds any equity or debt securities of the QFI.

Warrants

- The Treasury will receive warrants to purchase a number of shares of common stock of the issuer having an aggregate value of 15% of the Senior Preferred as of the date of investment. The initial exercise price for the warrants and the price for determining the number of shares subject to the warrants will be the market price of the common stock on the day of the investment (calculated on a 20-trading day trailing average), subject to future reduction under certain circumstances. The number of shares underlying the warrants will be subject to reduction in the event of a Qualifying Equity Offering.

- The warrants will have a 10-year term and will be immediately exercisable, in whole or in part.

- The Treasury will only be permitted to transfer or exercise one-half of the warrants prior to the earlier of the date on which the issues have received proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualifying Equity Offerings or December 31, 2009.

- The Treasury will agree not to exercise voting power with respect to any share of common stock issued to it upon the exercise of the warrants.

1.3. Summary

The Program would allow the Treasury to make substantial equity investments in QFIs that will bolster their capital levels. From an economic perspective, the Treasury has designed significant incentives for participating QFIs to raise new capital to redeem the Senior Preferred. While the Treasury will have a significant influence on the operations of participating QFIs as a result of the executive compensation and corporate governance provisions of the Act and Treasury's implementing guidance or regulations, the structure of the Senior Preferred and Warrants is passive.

II. FDIC's Temporary Liquidity Guarantee Program

In another effort to address the liquidity problems facing the banking sector, the Federal Deposit Insurance Corporation ("FDIC") announced that it was commencing a Temporary Liquidity Guarantee Program ("Liquidity Program"). Under the Liquidity Program, an Eligible Entity would include (i) an FDIC-insured depository institution, (ii) a US BHC, (iii) a financial holding company ("FHC"), and (iv) US SLHCs that only engage in activities permissible for FHCs.

According to the Liquidity Program, the FDIC will guarantee all NEWLY issued senior unsecured debt issued by Eligible Entities on or before June 30, 2009. The guaranteed forms of debt will include promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt.

The amount of debt covered by the guarantee may not exceed 125% of the debt of the Eligible Entity that was outstanding as of September 30, 2008, and that was scheduled to mature before June 30, 2009.

Guarantee coverage on eligible debt issued on or before June 30, 2009, will only be in effect for three years, even if the debt does not mature by that date. Guarantee coverage would also apply to non-interest bearing transaction deposit accounts ("Covered Deposits") held by FDIC-insured banks until December 31, 2009.

For the first 30 days of the Liquidity Program, all Eligible Entities will automatically be covered. Prior to the end of this initial period, an Eligible Entity must inform the FDIC if it wishes to opt out of the program. If an Eligible Entity opts out, the guarantee on its newly issued senior unsecured debt or its Covered Deposits will expire at the end of the 30-day period, regardless of the term of the debt or Covered Deposits. Eligible Entities that participate in the Liquidity Program will be subject to enhanced supervision by the FDIC and their primary federal regulator.

There will be no fee for the first 30 days of coverage under the Liquidity Program. After that time, Eligible Entities will be charged an annualized fee of 75 basis points multiplied by the amount of debt issued under the program. For Covered Deposits, there will be a fee of 10 basis points for deposits in excess of the current $250,000 insurance limit.

Authors and Contributors

For more information regarding this client alert, please contact your usual Fried Frank attorney or any of the attorneys listed below:

Washington, DC

Thomas P. Vartanian
+1.202.639.7200

David L. Ansell
+1.202.639.7011

Robert H. Ledig
+1.202.639.7016

Gordon L. Miller
+1.202.639.7173

Fried, Frank, Harris, Shriver & Jacobson LLP

New York
One New York Plaza
New York, NY 10004-1980
Tel: +1.212.859.8000
Fax: +1.212.859.4000

Washington, DC
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505
Tel: +1.202.639.7000
Fax: +1.202.639.7003

Frankfurt
Taunusanlage 18
60325 Frankfurt am Main
Tel: +49.69.870.030.00
Fax: +49.69.870.030.555

Hong Kong
in association with
Huen Wong & Co.
9th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
Tel: +852.3760.3600
Fax: +852.3760.3611

Shanghai
4oth Floor, Park Place
1601 Nanjing Road West
Shanghai 200040
Tel: +86.21.6122.5500
Fax: +86.21.6122.5588

Fried, Frank, Harris, Shriver & Jacobson (London) LLP

London
99 City Road
London EC1Y 1AX
Tel: +44.20.7972.9600
Fax: +44.20.7972.9602

Fried, Frank, Harris, Shriver & Jacobson (Europe)

Paris
65-67, avenue des Champs Elysées
75008 Paris
Tel: +33.140.62.22.00
Fax: +33.140.62.22.29

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