

Client Advisory | November 2008

The U.S. Department of the Treasury Term Sheet for Privately Held Financial Institutions Applying for the Capital Purchase Program

As part of the Treasury's effort to inject capital into the credit markets, the Treasury initiated the Capital Purchase Program ("CPP") in October. Access to the CPP was expanded on November 17, 2008 to include certain privately-held companies. Under the CPP, the Treasury purchases preferred shares and warrants from banks and other savings institutions to recapitalize their financial position.



*Theodore P. Augustinos,
Partner*



A.J. Kritzman, Associate

Who Qualifies?

On November 17, 2008, the Treasury expanded access to the CPP to privately-held companies designated as a Qualifying Financial Institution ("QFI"). The application deadline for those filing as a QFI is December 8, 2008.

To be considered a QFI, a company must be domestically controlled and must meet the requirements of one of the following three entity types: (i) a non-publicly traded top-tier Savings and Loan Holding Company ("SLHC") that engages solely or predominately in activities permissible for financial holding companies under relevant law; (ii) a U.S. bank or U.S. savings association organized in a stock form that is neither publicly traded nor controlled by a Bank Holding Company ("BHC") or SLHC; or (iii) a U.S. bank or U.S. savings association that is not publicly traded and is controlled by a SLHC that is also not publicly traded and does not engage solely or predominately in activities that are permitted for financial holding companies under relevant law, other than S-Corporations and Mutual Depository Institutions.¹ Further, a QFI must be organized under the laws of the United States or any jurisdiction within the United States.

Characteristics of the Preferred Shares

A QFI may issue an amount of preferred shares equal to not less than one percent of its risk-weighted assets and not more than the lesser of (i) \$25 billion and (ii) three percent of its risk-weighted assets.

The preferred shares will have a liquidation preference of \$1,000 per share or an equivalent value depending on the QFI's available authorized preferred shares. The preferred shares will have a Tier 1 status, will have a perpetual life term, and will be senior to the QFI's common stock and *pari passu* with existing equivalent preferred shares.

The preferred shares pay an annual interest rate starting at five percent for the first five years and nine percent thereafter.

Although the preferred shares will be non-voting, they will still retain class voting rights in regards to (i) the authorization or issuance of shares that are senior to the preferred shares, (ii) any amendments to the rights of the preferred shares, and (iii) any merger, exchange, or similar transaction which would adversely affect the rights of the preferred shares. Also, in the event that dividends are not paid on the preferred shares for six dividend periods, whether or not consecutive, the Treasury will have the right to elect two directors to the QFI's board.

The preferred shares will not be subject to any contractual restrictions on transfer or the restrictions of any stockholders' agreement that may be in effect among the QFI and its stockholders. However, the Treasury may not effect a transfer of the preferred shares that would result in the QFI becoming subject to the reporting requirements of the Exchange Act. If the QFI otherwise becomes subject to such reporting requirements,

¹ The Treasury is still considering the participation of S-Corporations and Mutual Depository Institutions in the CPP. The December 8, 2008 deadline will not apply to these two types of entities.

the QFI will file a shelf registration statement covering the preferred shares and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. In addition, the Treasury and its transferees shall have piggyback registration rights for the preferred shares.

Redemption of the Preferred Shares

The preferred shares may not be redeemed for a period of three years from the date of the Treasury's investment. After three years, the preferred shares 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 preferred shares shall be at 100% of the issue price, plus any accrued and unpaid dividends. The three year period may be shortened by a Qualified Equity Offering, whereby the QFI sells Tier 1 qualifying perpetual preferred stock or common stock for cash which results in aggregate gross proceeds to the QFI of not less than 25 percent of the issue price of the preferred shares.

Restrictions on the QFI

Participation in the CPP requires that the QFI submit to restrictions on declaring and paying dividends on any junior preferred shares, existing equivalent preferred shares, or common shares. A QFI must also seek the Treasury's consent for stock repurchases.

The QFI and its senior executive officers must modify or terminate all benefit plans, arrangements and agreements to the extent necessary to be in compliance with the executive compensation and corporate governance requirements of Section 111 of the Economic Emergency Stabilization Act of 2008 and any guidance or regulations issued by the Treasury on or prior to the date of the investment by the Treasury. Specifically, Section 111 (i) excludes incentives to senior executive officers of a QFI to take unnecessary and excessive risks that threaten the value of the QFI, (ii) provides for the recovery of 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, and (iii) prohibits the QFI from making any golden parachute payment to its top senior executive officers.

Compliance with the Section 111 limitations is required so long as the Treasury holds a debt or equity position in the QFI.

While the Treasury holds any equity securities of the QFI, the QFI may not enter into any transactions with related persons, as defined by Item 404 under Regulation S-K, unless (i) such transactions are on terms no less favorable to the QFI than could be obtained from an unaffiliated third party, and (ii) have been approved by the audit committee or comparable body of independent directors of the QFI.

Any company that received funding under the CPP must maintain its status as a bank holding company or thrift holding company while the Treasury holds any equity securities in the company. A bank holding company or thrift holding company seeking to terminate its status as such must fully redeem all preferred stock and warrants held by Treasury prior to terminating its status.

Characteristics of the Warrants

With limited exceptions, the Treasury will receive warrants, with a 10 year term, to purchase, upon net settlement, a number of net shares of preferred stock of the QFI having an aggregate liquidation preference equal to five percent of the value of the preferred shares on the day of the Treasury's investment in the QFI. The warranty allows the Treasury to profit as the participating company's value increases. The Treasury has stated its intention to exercise these warrants immediately.

The warrants shall have the same rights, preferences, privileges, voting rights and other terms as the preferred shares, except that (i) the warrants will pay dividends at an annual rate of nine percent and (ii) the warrants may not be redeemed until all the preferred shares issued to the Treasury under the CPP have been redeemed. The transferability restrictions on the warrants are similar to those found in the preferred shares mentioned above.

Community Development Financial Institutions

The treasury will forgo the warrants requirement at its discretion for a limited class of QFIs that receive an investment by the Treasury of \$50 million or less and that are certified as a Community Development Financial

The application deadline for those filing as a QFI is December 8, 2008.

Institution (“CDFI”). A CDFI is a specialized financial institution that works in market niches that are underserved by traditional financial institutions. CDFIs operate in economically distressed target markets, providing a unique range of financial products and services such as (i) mortgage financing for low-income and first-time homebuyers and not-for-profit developers, (ii) flexible underwriting and risk capital for needed community facilities, and (iii) technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas.

CDFIs include regulated institutions such as community development banks and credit unions, and non-regulated institutions such as loan and venture capital funds. To become a CDFI, an organization must submit a application to the CDFI Fund for review. The application must demonstrate that the applicant meets each of the following requirements: (i) be a legal entity

at the time of certification application; (ii) have a primary mission of promoting community development; (iii) be a financing entity; (iv) primarily serve one or more target markets; (v) provide development services in conjunction with its financing activities; (vi) maintain accountability to its defined target market; and (vii) be a non-government entity and not be under control of any government entity (Tribal governments excluded).

Applications to become a CDFI are also due by December 8, 2008 with an approval deadline of January 15, 2009. The CDFI Fund has pledged that it will streamline the certification process to 30 days in order to qualify for this exemption.

Edwards Angell Palmer & Dodge LLP will continue to monitor developments related to the above advisory and any forthcoming guidance on S-Corporations and Mutual Depository Institutions.

BOSTON MA | FT. LAUDERDALE FL | HARTFORD CT | MADISON NJ | NEW YORK NY | PROVIDENCE RI | STAMFORD CT
WASHINGTON DC | WEST PALM BEACH FL | WILMINGTON DE | LONDON UK | HONG KONG (ASSOCIATED OFFICE)

This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like any further information please contact:

Theodore P. Augustinos, Partner	860.541.7710	taugustinos@eapdlaw.com
Kathleen M. Conlon, Counsel	617.951.2294	kconlon@eapdlaw.com
Christopher D. Graham, Partner	401.276.6579	cgraham@eapdlaw.com
John G. Igoe, Partner	561.820.0242	jigoe@eapdlaw.com
V. Duncan Johnson, Partner	401.276.6477	djohnson@eapdlaw.com
Geoffrey Etherington, Partner	212.912.2740	getherington@eapdlaw.com
Bruce W. Raphael, Partner	617.951.2281	braphael@eapdlaw.com
A.J. Kritzman, Associate	860.541.7784	akritzman@eapdlaw.com

This advisory is published by Edwards Angell Palmer & Dodge for the benefit of clients, friends and fellow professionals on matters of interest. The information contained herein is not to be construed as legal advice or opinion. We provide such advice or opinion only after being engaged to do so with respect to particular facts and circumstances. The firm is not authorized under the U.K. Financial Services and Markets Act 2000 to offer UK investment services to clients. In certain circumstances, as members of the U.K. Law Society, we are able to provide these investment services if they are an incidental part of the professional services we have been engaged to provide.

Please note that your contact details, which may have been used to provide this bulletin to you, will be used for communications with you only. If you would prefer to discontinue receiving information from the firm, or wish that we not contact you for any purpose other than to receive future issues of this bulletin, please contact us at contactus@eapdlaw.com.

© 2008 Edwards Angell Palmer & Dodge LLP a Delaware limited liability partnership including professional corporations and Edwards Angell Palmer & Dodge UK LLP a limited liability partnership registered in England (registered number OC333092) and regulated by the Solicitors Regulation Authority.

Disclosure required under U.S. Circular 230: Edwards Angell Palmer & Dodge LLP informs you that any tax advice contained in this communication, including any attachments, was not intended or written to be used, and cannot be used, for the purpose of avoiding federal tax related penalties, or promoting, marketing or recommending to another party any transaction or matter addressed herein.

ATTORNEY ADVERTISING: This publication may be considered “advertising material” under the rules of professional conduct governing attorneys in some states. The hiring of an attorney is an important decision that should not be based solely on advertisements. Prior results do not guarantee similar outcomes.

**EDWARDS
ANGELL
PALMER &
DODGE**

111 Huntington Avenue
Boston, MA 02199
Tel 617.239.0100
Fax 617.227.4420
eapdlaw.com