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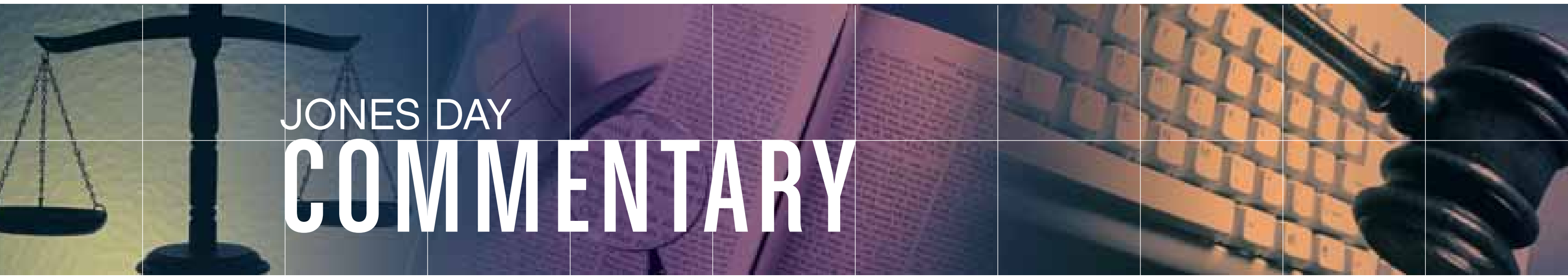

THE TARP CAPITAL PURCHASE PROGRAM EXPANDS TO INCLUDE SUBCHAPTER S U.S. FINANCIAL INSTITUTIONS

The Treasury has published its TARP Capital Purchase Program ("CPP") Term Sheet ("Sub S Term Sheet") for U.S. banks, S&Ls, and financial, S&L, and bank holding companies ("QFIs") that have valid elections to be taxed under Subchapter S ("Sub S") of the Internal Revenue Code of 1986 (the "Internal Revenue Code"). Participation is voluntary, but applications to participate must be made by February 13, 2009.

The original CPP had to be modified for Sub S QFIs because, under the Internal Revenue Code, Sub S banks and companies can only have one class of stock, which must be held by 100 or fewer eligible shareholders, plus their family members. Entities, such as the Treasury or a Treasury-sponsored entity, would not be eligible Sub S shareholders.

The CPP for Sub S has terms similar to the CPP for nonpublic banks and holding companies, but utilizes subordinated debentures instead of preferred stock to enable issuers to continue their Sub S status. This is an important development covering an estimated 2,500 to 3,000 Sub S depository institutions out of a total of approximately 8,400 FDIC-insured institutions.

SUBORDINATED DEBT

QFIs that have elected Sub S and are approved under the CPP may issue 30-year subordinated debentures ("Subordinated Debentures") to the Treasury in amounts of not less than 1 percent nor more than 3 percent of the QFI's risk-weighted assets under applicable bank regulatory capital rules. The TARP capital available likely will be set based on each QFI's December 31, 2008, balance sheet. The Subordinated Debentures will have the following terms:

Priority. Senior to common stock and all equity, and other "senior indebtedness" as defined for bank regulatory purposes, except where such debt is expressly made *pari passu* or subordinate to the Subordinated

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Debentures. The Subordinated Debentures should be senior to junior subordinated debentures issued in connection with trust preferred securities.

Interest Rate. 7.7 percent annual interest payable quarterly for the first five years after issuance, and 13.8 percent annually thereafter.

Deferral of Interest. For holding company QFIs, interest may be deferred, like trust preferred securities, for up to 20 quarters. Deferred interest is cumulative and compounded at the interest rate then applicable. Issuers may not make any payments on any trust preferred securities and likely on any other debt junior to the Subordinated Debentures during any period that interest is deferred on the Subordinated Debentures. Also, during such deferrals, no dividends may be paid on the issuer's common stock, including dividends needed by shareholders to pay taxes owed on their allocable shares of the Sub S issuer's taxable income.

Maturity. The Subordinated Debentures' stated maturity is 30 years, but after the 10th anniversary of issuance, the issuer is prohibited from paying any dividends on its common stock and from repurchasing any equity or trust preferred securities until all TARP CPP securities have been redeemed or repurchased.

Restrictions on Dividends. At any time when interest on the Subordinated Debentures has not been paid in full, QFIs will not be able to redeem or repurchase, or pay dividends or distributions on, shares of their common stock and trust preferred securities. Dividends on the issuing QFI's common stock may not be increased prior to three years after the Subordinated Debentures have been issued, without prior Treasury consent. Between the third and 10th anniversaries of issuance, the Treasury's consent is required for any increase in the total common dividends where the resulting dividend per share is greater than 103 percent of the prior year's annual dividend rate, *provided* no increase may be made as a result of any dividend paid in common shares, or any stock split or similar transaction. Upon and following the 10th anniversary of the issuance of the Subordinated Debentures, no dividends or repurchases of equity or trust preferred securities will be permitted. These restrictions no longer will apply when the CPP securities have been redeemed in whole or the Treasury has transferred all of its CPP securities to an unaffiliated third party. A securitization vehicle or investment pool where the Treasury is an initial sponsor or participant and holds an economic interest is *not* an "unaffiliated third party" for this purpose.

Dividends to Pay Taxes. Sub S companies do not pay taxes. Instead, their shareholders pay taxes on the company's taxable income. Sub S institutions generally pay dividends to their shareholders in an aggregate amount equal to the taxable income earned by the institution times the maximum individual tax rate to provide cash to enable shareholders to pay their allocable shares of the Sub S institution's taxable income. Treasury consent is not required for any increase in dividends for such purposes, if the increase is proportionate to the increase of the QFI's taxable income, and dividends are paid to permit shareholders to pay their taxes on their allocable shares of the QFI's taxable income. The Treasury and investors who purchase the Subordinated Debentures from the Treasury have the right to challenge the amount of the proposed tax distributions to the extent these exceed the amount believed necessary to pay shareholders' allocable shares of the taxable income generated by the QFI. Upon and following the 10th anniversary of issuance of the Subordinated Debentures, the prohibition on dividends appears to include dividends needed by shareholders to pay taxes.

Acceleration. Principal and accrued but unpaid interest on the Subordinated Debentures are accelerated and immediately payable generally upon the same terms as permitted for subordinated debt for bank regulatory capital purposes. Acceleration events include the bankruptcy or liquidation of the holding company or the receivership of a major bank subsidiary of the holding company, and deferral of interest on holding company Subordinated Debentures for more than 20 quarters.

Repurchases. Treasury consent is required for any repurchases by the QFI of equity securities or trust preferred securities other than repurchases in connection with benefit plans in the ordinary course of business, consistent with past practice or applicable income tax laws, until the 10th anniversary of issuance of the Subordinated Debentures, unless all the CPP securities have been redeemed in whole or these securities have been transferred by the

Treasury to unaffiliated third parties. No such repurchases are permitted after the 10th anniversary of issuance of the Subordinated Debentures.

Limited Voting Rights. Although debt securities are nonvoting generally, the Subordinated Debentures will provide class voting for authorizations of equity securities "that purport to rank" senior to the Subordinated Debentures, any proposed changes in the rights of the Subordinated Debentures, or any merger, exchange, or similar transaction that would adversely affect the rights of the Subordinated Debentures. Holders of Subordinated Debentures will have the right to elect two directors to the QFI's board of directors when interest is not paid in full for six periods, whether or not consecutive, until all interest for prior periods has been paid.

Redemption. The Subordinated Debentures are redeemable at the issuer's election, subject to applicable regulatory approvals, in the first three years following issuance only with proceeds from an offering by the QFI of securities of the same or higher tier of regulatory capital as the Subordinated Debentures (a "Qualified Equity Offering"). During the first three years after issuance, the minimum redemption amount is 25 percent of the total original principal amount of Subordinated Debentures. Thereafter, Subordinated Debentures are redeemable, in whole or in part, at the issuing QFI's election, subject to any required regulatory approvals. The redemption price is the issue price *plus* accrued but unpaid interest. The Warrants and Warrant Debentures are not reduced by any redemption of Subordinated Debentures.

Transferability. No contract restrictions are permitted on the transfer of Subordinated Debentures. Accordingly, the Subordinated Debentures cannot be subject to any shareholder agreement or similar arrangements restricting transfer. The issuing QFI is not required to register the Subordinated Debentures for resale with the SEC, unless the issuer becomes subject to reporting under the Securities Exchange Act of 1934 (the "1934 Act") or abandons its Sub S election. The Treasury will use commercially reasonable efforts not to transfer Subordinated Debentures in a manner that would subject the issuer to SEC reporting requirements under the 1934 Act.

WARRANTS

Similar to the CPP for private depository institutions and their holding companies, the Treasury requires the issuing QFI to issue warrants ("Warrants") to purchase additional Subordinated Debentures ("Warrant Debentures") in an amount equal to 5 percent of the Subordinated Debentures at an exercise price of $.01 per Warrant Debenture. These Warrants will have a 10-year term, but the Treasury intends to exercise these immediately. The Warrant Debentures will have the same terms as the Subordinated Debentures except:

- The interest on Warrant Debentures will be 13.8 percent annually, and
- Warrant Debentures can be redeemed only after all Subordinated Debentures have been redeemed.

No contract, including shareholder or similar agreements, may restrict the transfer of the Warrants. The terms of transfer of the Warrants are similar to those provided for the Subordinated Debentures.

EXECUTIVE COMPENSATION RESTRICTIONS

A condition to any Subordinated Debenture investment by the Treasury is that the QFI and its "senior executive officers" covered by the Emergency Economic Stability Act of 2008 ("EESA") must modify or terminate all benefit plans, arrangements, and agreements (including golden parachute agreements) to the extent necessary to be in compliance with the executive compensation and corporate governance requirements of Section 111 of EESA and Treasury guidance or regulations thereunder; in addition, they must agree, for as long as the Treasury holds any equity or debt securities of the QFI, to be bound by the same. Section 111 defines "senior executive officers" as the five highest compensated executive officers.

Among other things, the issuing QFI must:

- Ensure that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution.
- Claw back any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

- Prohibit making any golden parachute payment to a senior executive based on new Internal Revenue Code Section 280G(e).
- Agree not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive under new Internal Revenue Code Section 162(m)(5).

The QFI and its senior executive officers must deliver a waiver to the Treasury releasing any claims that the QFI and such senior executive officers may otherwise have as a result of the issuance of any regulations that modify the terms of benefit plans, arrangements, and agreements not in compliance with the executive compensation and governance provisions of Section 111 of EESA or any Treasury guidance or regulations issued thereunder prior to any investment by the Treasury.

A related *Commentary*, "Putting the Brakes on Executive Pay: Executive Compensation Limitations for Financial Institutions Participating in the Troubled Assets Relief Program Under the Emergency Economic Stabilization Act of 2008," may be found on the Jones Day web site, www.jonesday.com. The executive compensation provisions are similar to the restrictions otherwise imposed on depository institutions and their holding companies, and are not as restrictive as those imposed under the Treasury's Targeted Investment Program (January 2, 2009).

On January 16, the Treasury published revisions to Notice 2008-PSSFI regarding Executive Compensation for TARP recipients, as well as an Interim Final Rule and Frequently Asked Questions on Executive Compensation requirements under the Capital Purchase Program. Sub S QFIs should pay special attention to these reporting requirements, which will be new for such issuers.

AFFILIATE TRANSACTION LIMITS

As long as the Treasury holds any debt or equity securities of the QFI, the QFI and its subsidiaries may not enter into transactions with "related persons" (as defined in SEC Regulation S-K Item 404) unless such transaction has:

- Terms no less favorable to the QFI and its subsidiaries than can be obtained from an unaffiliated third party.
- Been approved by the audit committee or a comparable body of the independent directors of the QFI, or if there are no independent directors, the Board has written documentation supporting its determination that the transaction's terms are no less favorable than can be obtained from an unaffiliated third party.

OPEN ITEMS

The Sub S Term Sheet provides terms that are similar to, but not entirely consistent with, the terms for subordinated debt and trust preferred securities under Federal Reserve and other bank regulatory guidelines. The Subordinated Debentures are expected by the Treasury to be Tier 2 capital for depository institutions and Tier 1 capital for bank holding companies. The Term Sheet notes that the Federal Reserve will have to issue a rule designating the Subordinated Debentures as Tier 1 capital for bank holding companies similar to the interim final rule for the initial TARP CPP that the Federal Reserve adopted on October 16, 2008. 73 F.R. 62851 (October 22, 2008).

It is expected that changes to the definitive documents for the CPP Subordinated Debentures also will be needed to make these more consistent with the Federal Reserve and other bank regulators' capital requirements, including subordination to "senior indebtedness" of the issuer, the exemption of voting rights from the regulatory limits on covenants, and disclosure that the Subordinated Debentures are not deposits and are not FDIC insured. Further clarification is desirable to avoid including the Subordinated Debentures issued by banks or thrifts as "deposits" subject to reserve requirements under Federal Reserve Regulation D. It is unclear, but we expect the Federal Reserve will not limit the amount of Subordinated Debentures that are includable as regulatory capital, since the Federal Reserve took this approach on TARP preferred stock.

The Federal Reserve's rule will be of great interest since historically the Federal Reserve does not recognize long-term subordinated debt with interest deferral features as Tier 1 capital, except in the case of trust preferred securities.

WHAT TO DO NOW

The Treasury has provided a unique opportunity for Sub S financial institutions to raise capital in difficult markets while maintaining their Sub S status. We recommend that every Sub S depository institution or its holding companies that may be a QFI consider participating in the Treasury Program. Potential participants should:

- Review their capital structure and needs, executive compensation arrangements, and employee benefit plans and alternatives.
- Review and prepare plans and consider sources of funds for retiring the Subordinated Debentures within 10 years.
- Review whether the Federal Reserve will require that any proceeds downstreamed by a bank holding company to bank subsidiaries be in the form of subordinated debt that "mirrors" the Subordinated Debentures, and whether such subordinated debt, which is Tier 2 capital at the bank level, meets the bank's needs.
- Review existing charters and debt instruments in advance.
- Review existing shareholder agreements. The restrictions on share repurchases in the CPP may necessitate changes to Sub S shareholder agreements, including buy-sell arrangements, that will need modification for consistency with the TARP CPP. This may take some time, so planning should begin now.
- Carefully monitor developments in Treasury and regulatory reporting requirements, including uses of proceeds and lending patterns. *See* FDIC FIL-1-2009 (Jan. 12, 2009); Letters from Lawrence Summers to Senator Henry Reid (Jan. 15, 2009) and to Congressional Leaders (Jan. 12, 2009); the Department of the Treasury's Press Release HP-1347 (January 8, 2009); and "Interagency Statement on Meeting the Needs of Creditworthy Borrowers" (Nov. 12, 2008).
- Monitor legislative developments, including the TARP Reform and Accountability Act of 2009 (H.R. 384).

Participation in the Treasury Program may be combined with, and may facilitate, other capital raising, including other debt incurred by "small" bank holding companies with less than $500 billlion of assets.

Applications are due by February 13, 2009, but if an application has already been filed, no additional application is needed. Interested institutions should also contact their bank's and their holding company's regulators promptly to identify and resolve issues and avoid delays.

LAWYER CONTACTS

For further information or to receive any of Jones Day's failed bank summaries or a summary of all 2008 bank failures, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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