



JONES DAY
COMMENTARY

THE FINANCIAL STABILITY PLAN'S CAPITAL ASSISTANCE PROGRAM AND AN UPDATE OF THE TARP CAPITAL PURCHASE PROGRAM

The Treasury announced on February 25, 2009, details of its Capital Assistance Program (the "CAP") under the Treasury's new Financial Stability Plan ("FSP"). The Financial Stability Plan was announced on February 10 and will be funded, at least in part, from the second \$350 billion of funds authorized by the Emergency Economic Stabilization Act of 2008 ("EESA").

CAP consists of two elements:

- A forward-looking Supervisory Capital Assessment Program (the "Stress Test") to determine whether any of the U.S. banking organizations holding \$100 billion or more of assets need to establish an additional capital buffer.
- Access to capital from the Treasury under the CAP in the form of mandatory convertible preferred stock ("CAP Preferred Stock") and warrants to purchase issuer common stock ("Warrants") for U.S. banks, S&Ls, and financial, S&L, and bank holding companies ("QFIs") whose common stock is traded publicly. QFIs are defined identically for the CAP

and the Troubled Assets Relief Program's ("TARP") Capital Purchase Program ("CPP"). The Treasury did not commit a set amount of money to the CAP or limit the amount of the CAP.

Participation in the Stress Test is mandatory for U.S. financial institutions with assets in excess of \$100 billion, which include the 19 biggest U.S. bank holding companies holding two-thirds of all banking assets. Other QFIs will have the opportunity to access the CAP only if they submit to the Stress Test and are deemed viable and eligible by the Treasury upon recommendation of the QFI's federal bank regulations. The CAP approval criteria and process are identical to CPP. All eligible QFIs (large and small) need to apply for CAP capital by May 25, 2009. The Treasury and the federal banking agencies have released only the CAP term sheets for the publicly traded QFIs. Separate term sheets will be available in the future for institutions that are not publicly traded or have elected to be taxed as Subchapter S corporations. The Treasury

indicates that term sheets for mutual institutions will be provided, but no term sheets have been provided yet for mutuals under the CPP.

Investments under the CAP will be held in a separate Financial Treasury Stability Trust (the “FSP Trust”) that will manage CAP investments. The terms of the FSP Trust and its management have not been disclosed. Presumably, the Treasury will coordinate with the Federal Reserve to avoid the FSP Trust being classified as a “company” subject to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). This will require consistency with the approach the Federal Reserve has taken with foreign banking organizations where control has shifted to trusts established by foreign governments as a result of foreign government intervention due to the credit crisis.

TERMS OF THE CAP

CAP Preferred Stock. QFIs may issue CAP Preferred Stock in amounts of not less than 1 percent nor more than 2 percent of the QFI's risk-weighted assets *plus* any additional amount that is issued and used to redeem preferred shares sold to the Treasury under the CPP and the Targeted Investment Program. Capital in excess of this amount is available as “exceptional assistance” at the Treasury's discretion, in consultation with the appropriate federal bank regulators. The special terms and conditions applicable to exceptional assistance have not been disclosed. QFIs also are allowed to apply for the CAP Preferred Stock to redeem outstanding TARP CPP Preferred Stock. Although CAP Preferred Stock looks more like tangible common equity or “TCE” than CPP Preferred Stock, it is unlikely that CPP participants will seek to refund outstanding CPP Preferred Stock with higher cost, more dilutive CAP Preferred Stock.

The CAP Preferred Stock will have the following terms that are different from the terms of preferred shares sold under CPP:

Mandatory and Optional Conversion. CAP Preferred Stock will be converted mandatorily into the issuer's common stock (“Common Stock”) seven years after its issuance. The QFI may convert CAP Preferred Stock in whole or in part at the specified conversion price (“Conversion Price”) at the option

of the QFI at any time, subject to the approval of the QFI's primary federal banking regulator or at the option of the Treasury upon specified corporate events such as certain sales, mergers, or changes of control of the QFI. Upon conversion, the issuer will pay any accrued but unpaid dividends on the CAP Preferred Stock, either in cash or shares of its Common Stock valued as of the second trading day preceding conversion.

Conversion Price. The conversion price is set at 90 percent of the average closing price for the Common Stock for the 20 trading days ending February 9, 2009, subject to antidilution adjustments (the “Conversion Price”). The Conversion Price may be further reduced by 15 percent for each six-month period, up to an aggregate of 45 percent, if:

- the QFI does not have sufficient available authorized shares of common stock reserved for the CAP Preferred Stock and the CAP Warrant; and
- approval by the QFI's shareholders is required to provide the required shares of QFI Common Stock (the “Shareholder Consent”), but is not obtained.

Dividend Rate. Nine percent cumulative annual dividends, payable quarterly. This rate will increase to 20 percent after six months, if the necessary Shareholder Consent is not received by then, and shall remain at such level until the Shareholder Consent is received.

Dividend Stopper. At any time when dividends on the CAP Preferred Stock have not been paid in full, QFIs will not be able to redeem or repurchase, or pay dividends on, shares of their capital stock that are *pari passu* or junior to the CAP Preferred Stock. Dividends on the issuing QFI's Common Stock may not be greater than \$0.01 per share per quarter, unless the Treasury consents to a higher amount.

Limited Voting Rights. The CAP Preferred Stock, prior to conversion, has the same limited voting rights as the CPP Preferred Stock. Unlike the CPP, following conversion of the CAP Preferred Stock, the Treasury will have and may exercise the voting rights as a holder of the QFI's Common Stock. The Treasury proposes to publish a set of principles governing the exercise of these voting rights prior to closing any CAP transaction. QFIs will need to consider this aspect of CAP carefully and are unlikely to request CAP while these principles are being determined.

Transferability and Resale Shelf. No contractual restrictions on transfers of CAP Preferred Stock are permitted. The issuing QFI is required to promptly file a shelf registration statement covering the resale of the CAP Preferred Stock and the underlying Common Stock, and also to grant the Treasury piggyback registration rights for such securities.

Redemption. CAP Preferred Stock is redeemable at the issuing QFI's election, subject to applicable prior regulatory approval, and only with proceeds from an offering of Tier 1 Preferred Stock or Common Stock by the issuing QFI (a "Qualified Equity Offering"). At least 25 percent of the amount of CAP Preferred Stock originally issued must be redeemed. The redemption price is the CAP Preferred Stock's issue price *plus* accrued but unpaid dividends for the first two years after issuance, and thereafter is the greater of (a) the issue price *plus* unpaid dividends and (b) the as-converted value of such shares.

Mandatory Sale. After the mandatory conversion date, the Treasury will use reasonable efforts to sell at least 20 percent of the total Common Stock underlying the CAP Preferred Stock annually. At that time, the QFI may, subject to the approval of the QFI's primary federal banking agency, repurchase any of such shares at a price equal to the greater of (a) the Conversion Price and (b) the market price on the date of repurchase with proceeds from the sale of the QFI's Common Stock issued or from retained earnings.

Listing. The QFI must apply to list the shares of Common Stock underlying the CAP Preferred Stock on the national securities exchange where its Common Stock is listed.

Corporate Governance and Compensation. The QFI and its covered officers and employees must comply with the Treasury's rules and guidance on compensation, transparency, accountability, and reporting, including reporting on loan volumes by types, as published and in effect at the time the CAP investment is closed.

WARRANTS

In connection with its purchase of any CAP Preferred Stock, the Treasury will require the issuing QFI to issue Warrants to purchase the QFI's Common Stock in an amount equal

to 20 percent of the amount of CAP Preferred Stock purchased. The Warrants' exercise price will be the same as the Conversion Price. Except for the exercise price, the terms of the Warrants are largely identical with the terms of Warrants issued under CPP.

The terms of the Warrants include:

- **Term:** 10 years.
- **Exercise:** Immediately exercisable, in whole or in part.
- **Transferability and Resale Shelf:** No contractual restrictions on transfer are permitted. The issuing QFI is required to promptly file a shelf registration statement covering the resale of the Warrants and the underlying Common Stock and to grant the Treasury piggyback registration rights for the Warrants and the underlying Common Stock.
- **Listing:** The issuing QFI will apply for listing of the Common Stock issuable upon exercise of the Warrants on the national securities exchange where the QFI's Common Stock is listed.
- **Voting:** The Treasury will not exercise voting rights with respect to the shares of Common Stock received upon exercise of the Warrant.
- **Substitution:** Where the issuing QFI's common stock is no longer listed or traded on a national securities exchange or where shareholder approval has not been received within 18 months after the issuance of the Warrants, the Treasury may elect to exchange the Warrants for senior debt or another security of the issuing QFI to appropriately compensate the Treasury, as it may determine, for the value of the Warrants.

OTHER CONDITIONS OF THE CAP

QFIs that sell CAP Preferred Stock will be subject to the executive compensation and governance requirements under EESA, as recently amended by the Dodd Amendment to the American Recovery and Reinvestment Act of 2009 (the "ARRA"). Details of the terms of the Dodd Amendment can be found at "[Revised Executive Compensation Requirements for Participants Under the Troubled Assets Relief Program](#)" (February 2009) on the Jones Day web site, www.jonesday.com. The Treasury is expected to propose rules to implement these amendments to EESA.

As part of the application process, QFIs must submit a plan of how they intend to use this capital from the CAP to preserve and strengthen their lending capacity, and such plans will be made public when the QFI receives the CAP capital. Although the application is stated to be confidential, the bank regulators are requiring QFIs to make very specific requests for confidentiality under the Freedom of Information Act. QFIs receiving capital through the CAP also will be required to submit monthly reports to the Treasury on their lending activity broken out by loan category.

STRESS TEST

The Treasury's release explains that the Stress Test is intended to determine whether an additional capital buffer, particularly one that strengthens the composition or quality of capital, is needed for the institution to withstand "more stressful conditions." Should such a need exist, a banking organization will have six months to either raise the capital privately or access it through the CAP. Although not clear, it is possible that the 19 largest banking organizations could be forced to take CAP capital or raise money privately, if deemed necessary by their regulators after evaluating the Stress Test. For all other QFIs, CAP will not be available if they fail the Stress Test in the same way that CPP was denied to QFIs. If an organization has been denied CPP capital or has been approved for the CPP subject to conditions that have not been or cannot be met, it appears that these institutions will not have access to the CAP. For further information on the Stress Test, see "[The Supervisory Capital Assessment Program: A Stress Test for U.S. Banking Organizations](#)" (March 2009) at www.jonesday.com.

OPEN ITEMS

Similar to the CPP when it was released in October 2008, the Treasury has left open a number of questions on the CAP, such as how the terms of the CAP will be modified for the QFIs that are privately held or have elected to be taxed as Subchapter S corporations. The principles that will govern the voting of any Common Stock held by the Treasury upon conversion of the CAP Preferred Stock have not yet been

disclosed. It is unclear whether the Treasury will release to the public the Stress Test formula, the assessment results from such assessments, or any amount of capital buffer that they believe may be required of any institution. These generally should be confidential initially as part of the bank regulatory supervisory process, but minimum capital requirements likely will be disclosed by public institutions.

Issuers should also consider carefully the Federal Reserve's SR Letter 09-4 (February 24, 2009) on capital planning, dividends, redemptions, and repurchases of capital instruments when evaluating the CPP, CAP and other capital measures, capital adequacy, and the possible redemption of CPP and CAP capital.

UPDATE ON THE CPP

Section 7001(g) of the ARRA mandates that, subject to consultation with the appropriate federal bank regulator, the Treasury "shall permit a TARP recipient to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institutions replaced such funds from any other source or to any waiting period." Upon repayment of such assistance, the Treasury is directed to liquidate Warrants associated with such assistance at the current market price. During the last week of February, the Treasury released FAQs (the "ARRA FAQs") addressing some of the changes made to CPP by the ARRA.

The ARRA FAQs outline a redemption process for CPP Preferred Stock that may be more difficult and conditional than represented by the drafters of the ARRA. Notices of redemption of any CPP capital must be provided to the recipient's primary bank regulator and to the Treasury, who will consult and then discuss their determinations with the QFI. The factors to be considered in these consultations and decisions have not yet been determined. The Treasury is also requiring that a minimum of 25 percent of the CPP issue be redeemed under Section 7001(g) of the ARRA. Warrants issued pursuant to the CPP may also be purchased upon redemption of the Treasury's investment in the CPP Preferred Stock, *provided* the warrants are purchased at "fair

market value” as defined in Section 4.9 of the CPP Securities Purchase Agreement. To the extent warrants are not repurchased, the Treasury will attempt to liquidate the registered warrants and the underlying Common Stock as soon as possible pursuant to the CPP resale registration statement. The Treasury stated that all accrued but unpaid dividends on the CPP must be paid at the time of any redemption.

The issuance of CAP Preferred Stock is a “qualified equity offering” under the CPP to the extent proceeds from the sale of CAP Preferred Stock are used to redeem CPP Preferred Stock. Such redemptions will also count toward the proceeds that are required to be raised to reduce the number of shares of common stock underlying the CPP Warrant. CAP Preferred Stock proceeds may also be used to reduce preferred shares sold to the Treasury under its Targeted Investment Program, in whole or in part, in accordance with the terms of the Targeted Investment Program.

Following ARRA and the publicity surrounding the compensation and governance provisions of the ARRA that emerged upon its passage, as well as the uncertainty of Treasury regulations thereunder, we understand that a number of TARP CPP applicants have delayed or canceled their proposed CPP closings. Various institutions recently have announced that they are seeking approval to redeem the CPP capital they received earlier. The ARRA will also discourage those not required to apply to the CAP from doing so.

The terms of the CAP are much less favorable than those available under the CPP, and various issuers may seek private capital instead of becoming subject to the requirements placed upon TARP recipients under ARRA and the CAP, as well as the uncertainty of future changes. The conversion and warrant exercise pricing provisions of the CAP Preferred Stock and Warrant will substantially dilute QFIs’ existing common shareholders and make it more difficult to raise common stock and convertible securities in the markets. When these economic factors are considered with the uncertainty raised by the ARRA and future changes, including the Treasury’s voting principles, it seems likely that the CAP will have few voluntary participants.

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