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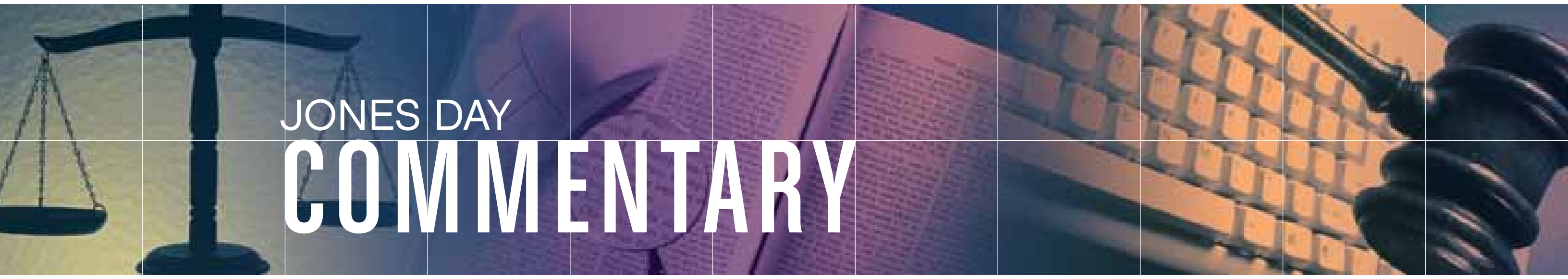

VALUE APPRECIATION INSTRUMENTS IN FDIC-ASSISTED ACQUISITIONS

Since the beginning of 2008 through May 2011, 366 banks and thrifts have failed in the United States. The FDIC, as receiver or conservator, has resolved most of these failed institutions by disposing of their assets and liabilities in purchase and assumption transactions (each, a "P&A"). Section 13(c)(4) of the Federal Deposit Insurance Act (the "FDI Act") requires the FDIC to resolve failed banks in the least costly manner. Value appreciation instruments or warrants (collectively, "VAIs") have been taken from time to time by the FDIC from winning bidders to reduce the costs to the FDIC's Deposit Insurance Fund ("DIF") of resolving insured depository institutions.

THE APPEAL OF VAIs

Bids to the FDIC usually include assumptions of deposits, with or without deposit premiums. During 2008–2011, most resolutions have included no deposit premium. Assets are purchased generally based upon their book value at the date of the failed bank's closure. In most whole P&A transactions, assets have sold at a discount. Usually, the asset purchase prices are discounted more where FDIC loss sharing is not offered or bid, loss sharing is limited, or the assets are particularly risky.

Early in the current cycle of bank failures, the FDIC was offering terms, including loss sharing, that were very attractive. In some cases, the failed institution was large enough and attracted interest from a number of bidders, so that the FDIC was able to request VAIs as part of the bid process. For bidders, the VAI may be an attractive way to enhance a bid's chances for success in a contested failed bank auction, whether or not a VAI was included in the FDIC's bid terms. The first VAIs were warrants issued to the FDIC by BankUnited as part of its winning, private equity-backed bid for BankUnited, FSB, ("BankUnited") Coral Gables, Florida on May 21, 2009, and were contingent upon a future qualifying IPO.

In certain public company acquisitions of failed banks, the buyer's common stock prices increased, sometimes materially, on the Monday following the announcement of an FDIC-assisted acquisition after the close of the markets on the preceding Friday. Monday morning public offerings were sometimes launched following a failed bank acquisition, in part upon the issuer's prospects and the strength of its stock price resulting from the FDIC-assisted acquisition. The FDIC, to reduce the DIF's cost of resolutions, began to consider VAIs as possible means to capture some of such stock market gains. At the same time, bidders saw VAIs as a way to distinguish their bids from other bids in a competitive bidding process.

The first example of this type of VAI was issued on December 4, 2009, when AmTrust Bank ("AmTrust") was sold by the FDIC as receiver to New York Community Bank ("NYCB"). NYCB, whose parent was a publicly traded company, was one of five bidders that submitted 13 bids for AmTrust. NYCB offered a VAI as part of its nonconforming, but winning, bid.

HOW VAIs WORK

The FDIC views VAIs as additional consideration in a failed bank resolution that reduce the DIF's costs. VAIs are rights granted to the FDIC by buyers to purchase an amount of buyer common stock at a fixed exercise price or to receive cash representing the appreciation of the buyer's stock over the VAI's exercise price.

While some VAIs allow the FDIC the right to elect to settle in stock or cash, many VAIs can be settled only in cash. If exercised by the FDIC, VAIs that are settled in stock can increase the bidder's capital base. Usually, however, the VAIs are settled in cash for the difference or spread between the exercise price and the market price at the date of exercise by the FDIC. In the event a VAI is not exercised, the successful bidder may recognize future income when the initial cost of the VAI is reversed. Where nonpublic bidders use VAIs, exercise may be contingent on an initial public offering ("IPO"), which meets certain qualifying conditions, and exercise may be restricted to a certain period after the IPO or upon achieving a certain price in the IPO.

Settling an exercise of VAIs in cash rather than shares of stock avoids dilution to the buyer and is potentially less expensive to the buyer than issuing additional shares. Cash settlement also allows the FDIC to avoid the risk of changes in the market prices of the buyer's common stock while the FDIC disposes of such shares. Cash settlement may also be highly attractive in the case of privately held buyers, including blind pool-financed shelf charter buyers, who lack a current market for their securities.

Historically, VAIs' exercise periods have ranged from as little as 14 days after the bid to as long as 10 years. The shorter exercise periods focused on the immediate gain in the market value of the buyer's common stock following the announcement of a winning bid for an FDIC-assisted purchase. Longer exercise periods allowed the FDIC to take advantage of rising stock prices resulting from well-managed, value-added acquisitions, and not just potential temporary gains that may occur upon the announcement of an FDIC-assisted transaction. Blind pool buyers that will go public in the future also would likely have longer-term VAIs. At the same time, any gains to the FDIC on longer-term warrants may be attributable less to the failed bank transaction and more to the buyer's success generally.

Given the tightened and less buyer-friendly terms of FDIC-assisted transactions over the course of the last year and half, it is likely that longer-term VAIs will be more prevalent than shorter ones. Of the 22 VAIs used in 2010 and through April 2011, 11 had terms of 60 days or more, and seven VAIs came from private buyers, mostly blind pool-financed, shelf charters. The acquisition of Westernbank PR, Mayaguez, Puerto Rico ("Westernbank PR"), by Banco Popular de Puerto Rico ("Banco Popular") in April 2010 and the acquisition of Legacy Bank, Scottsdale, Arizona, by Enterprise Bank and Trust in January 2011, both included VAIs with exercise periods that remained open for almost a full year. At least three VAIs issued by winning bidders, including a blind pool-financed bidder and a private equity-backed bidder, have included 10-year terms.

Longer-term VAIs have relatively simple anti-dilution provisions, requiring only "appropriate adjustments" to the number of shares and exercise prices.

In addition, in the last year, several buyers have capped the amounts payable to the FDIC per share upon exercise of VAIs. These caps limit the buyer's VAI cost and make accounting for the acquisition more predictable. Some VAIs cap the amount payable to the FDIC upon exercise at an express dollar amount, while at least one buyer has capped its potential VAI obligation at a certain percentage of stock appreciation.

CURRENT STATE OF VAIs

The FDIC may segment VAIs by bidders/issuers whose stock (i) is publicly traded and has a public float in excess of $50 million ("Large Bidders") or (ii) is not publicly traded and/or does not have a public float in excess of $50 million ("Small Bidders"). Large Bidders may be required by the FDIC to settle the VAIs in cash upon exercise by the FDIC, while the FDIC reserves the right to exercise VAIs issued by Smaller Bidders for either shares of common stock or cash.

Bidders may choose whether or not to include VAIs in their bids, and if so, the number of VAIs issued to the FDIC. The remaining terms, such as exercise price and expiration date, are determined by formulas preestablished by the FDIC. The FDIC has specified that conforming bids include VAIs in amounts "material and proportional to the relative benefit and value of the loss-sharing agreement" to the bidder.

Large Bidder VAIs. Determining the number of units to be issued requires the bidder to estimate the potential value of the VAIs based on projected stock prices, which may or may not be realized. The FDIC calculates the estimated value of VAI units.

VAI terms that may be specified by the FDIC in Large Bidder bid forms include:

- **Initial Exercise Date:** The fifth business day after the FDIC's appointment as receiver of the failing institution.

- **Expiration Date:** The one-year anniversary of the FDIC's appointment as receiver of the failing institution.

- **Exercise Price:** The simple average of the issuer's common stock price for the previous 20 trading days prior to the bid date for the failing institution.

- **Determination Price:** The issuer's "volume weighted average price," or "VWAP," over the two trading days immediately prior to the day of notification by the FDIC to the issuer, as displayed under the heading "Bloomberg VWAP" on the issuer's Bloomberg page.

- **Transferability:** VAI units are fully transferrable by the FDIC without the consent of the issuer.

- **Anti-Dilution:** The FDIC expects that the VAIs should contain standard anti-dilution provisions for convertible securities (for example, stock dividends, stock splits, cash dividend increases, and rights offerings).

- **Jurisdiction:** The FDIC will submit only to the jurisdiction of the Southern District of New York or the U.S. Court for the District of Columbia.

The settlement amount equals the difference between the exercise price and the determination price multiplied by the number of VAI units issued.

The FDIC does note, however, that it is willing, in extenuating circumstances, to consider settlement in shares of stock of a bank holding company. The FDIC cannot purchase common stock of an FDIC-insured depository institution. But, in the event of a settlement in stock, the FDIC demands registration rights and requires the issuer to reimburse all FDIC expenses related to compliance with applicable laws. Such a warrant would be fully transferrable and become exercisable only upon the FDIC's sale of the underlying shares to a third party.

Small Bidder VAIs. The FDIC's form VAIs for Small Bidders have the same general terms but include other provisions to accommodate the nonpublic nature or smaller public float of Small Bidders.

The exercise price of the VAI units is determined based on the issuer's tangible book value per common share as of the end of the most recent fiscal quarter. In the event the issuer does not have such information because it is in formation, then the exercise price is based on the issuer's pro forma capitalization as of the bid date.

The VAIs of Small Bidders are exercisable only upon a Trigger Event, which is (1) the date the issuer becomes publicly traded, if it is not already, and reaches a public float threshold of more than $50 million for 30 consecutive trading days, whether by stock appreciation or an IPO (a "Public Float Event") or (2) the issuer is sold or disposes of all or substantially all of its assets (a "Sale Event"). For this purpose, an IPO is the first underwritten public offering of bidder common stock where the stock will trade on a national securities exchange with a public float greater than $50 million. The term of VAIs for Small Bidders is one year after a Public Float Event or the second anniversary of the FDIC's appointment as receiver of the failed bank.

The Determination Price is determined in the same way it is for the Large Bidders, generally, but in the case of a Sale Event, it is the value of the consideration received per common share of the bidder upon closing of the sale. The FDIC can also elect to take settlement of the VAIs in cash or shares of common stock of a bank holding company. If the FDIC elects a cash settlement, the calculation of the settlement price is the same as for Large Bidders.

If the FDIC elects to exercise the VAI for common stock, the FDIC will receive a number of shares in a cashless exercise based on the spread between the Determination Price and the Exercise Price multiplied by the Determination Price. In addition, the issuer is required to provide transferable registration rights and pay all costs of compliance with laws regarding registration, filing, and other associated costs payable by the issuer.

Unlike Large Bidders, whose VAIs may expire unexercised by the FDIC, in the event the FDIC chooses not to exercise or where a Trigger Event does not occur within the exercise period, Small Bidders' VAIs are subject to an "alternative consideration fee." The alternative consideration fee is a cash fee per VAI unit based on the issuer's tangible book value per common share for the most recent prior quarter times the prevailing average price to tangible book multiple of the companies included in the Nasdaq Bank Index at such date.

The FDIC's expectations and VAI terms are subject to change at the discretion of the FDIC. Additionally, bidders may always submit nonconforming bids regarding both general P&A terms, as well as VAIs.

USES OF VAIs

The terms of VAIs granted to the FDIC vary significantly depending on the failed bank, the buyer, and the number of bidders and bids. In a competitive bid situation, a VAI may be very useful to distinguish a buyer's bid from the crowd.

Wintrust Financial Corporation, Lake Forest, Illinois ("Wintrust"), and Bond Street Management, LLC, Miami, Florida ("Bond Street") have been the most frequent issuers of VAIs. These acquirers' 10 VAI transactions represent 45 percent of all VAI transactions disclosed from 2008 through April 2011.

Wintrust has completed five FDIC-assisted acquisitions that included VAIs since 2009, most recently in connection with the acquisition of The Bank of Commerce, Wood Dale, Illinois, on March 25, 2011.

Bond Street, a blind pool-financed company with a shelf charter national bank, Premier American Bank, N.A. (including its Florida Community Bank division), completed three FDIC-assisted acquisitions that included VAIs in 2010 and two through April 2011. It is not yet known whether Bond Street issued a VAI in connection with its May 6, 2011 FDIC-assisted purchase of Coastal Bank, Cocoa Beach, Florida. Although a VAI was issued in connection with Bond Street's purchase of First National Bank of Central Florida on April 29, 2011, no VAI was issued in its linked-bid purchase of Cortez Community Bank, Barnesville, Florida on the same day.

Bond Street filed a registration statement with the SEC on May 16, 2011 that first disclosed details of Bond Street's VAIs. The VAIs issued in its first two deals in January 2010 had 10-year terms and were payable in cash. The latest VAIs had two-year terms and were payable in stock or cash, granted the FDIC registration rights, and were exercisable within 60 days of a qualifying IPO or a Sale Event. As of the end of 2010, Bond Street had not recognized any expense related to its VAIs since it could not determine the probability or timing of an IPO. More information is expected when Bond Street updates its SEC filing to include more recent financial statements.

Blind pool-financed companies do not always use VAIs, however. No VAI was issued in connection with Certus Bank, N.A.'s initial FDIC-assisted acquisition on January 21, 2011. Certus is a shelf charter subsidiary of Blue Ridge Holdings, Inc. ("Blue Ridge"), which raised its capital through a blind pool offering. No disclosure has been made as to whether Blue Ridge issued VAIs in connection with its purchases of Atlantic Southern Bank and First Georgia Banking Company on May 20, 2011.

Apparently, only two private equity-backed buyers of failed banks (BankUnited and First Michigan Bank, now named Talmer Bank & Trust) have used VAIs.

VALUE OF VAIs TO THE FDIC

The FDIC's calculation of the value of VAIs under its least cost test likely varies with each transaction and generally is not publicly available. The FDIC has realized significant value from VAIs in at least two transactions. In BankUnited, the FDIC received a 10-year warrant exercisable 10 days following the buyer's IPO or sale, subject to certain minimum pricing conditions for the IPO. BankUnited's buyer priced its IPO on February 2, 2011, approximately 21 months after the resolution of BankUnited by the FDIC. The IPO did not meet the minimum price required for the FDIC to exercise the warrant. Nonetheless, the buyer company paid the FDIC $25 million in cash for cancellation of its warrant.

The benefit realized by the FDIC in connection with AmTrust substantially exceeded the FDIC's original valuation of the VAI in connection with evaluating bids. The FDIC Office of Inspector General's Report No. AUD-11-005, "The FDIC's Franchise Marketing of AmTrust Bank" (March 2011) (the "OIG Report") indicates that when NYCB purchased AmTrust Bank in December 2009, the FDIC received a 14-day warrant entitling it to shares or cash equal to the excess of NYCB's average share price over $12.33. At the time of the transaction, the OIG Report stated that the FDIC estimated the aggregate value of this VAI at $10.7 million. Upon the exercises of its warrants in two stages, however, the FDIC received a total of approximately $23.3 million in cash, 118 percent more than the FDIC's estimate for bid and least cost test purposes. It is possible that, in addition to the other modeling issues raised in the OIG Report, the FDIC's model may have underestimated the value of the VAI. It is also possible that the market price of NYCB stock was far stronger following its purchase of AmTrust than predicted at the time of the deal.

Potential bidders for FDIC-assisted acquisitions should consider VAIs and their costs very carefully, especially where the VAI is settled only in buyer common stock, or in the case of Small Bidders, where an alternative consideration fee is payable in cash regardless of the buyer's stock price performance. As discussed above, some buyers limit payouts by including a cap in the VAI on the amount due to the FDIC upon exercise of the VAI, although these may cause their bids not to conform to the FDIC's bid rules.

The attached table outlines the 24 failed bank acquisitions since 2009 (through April 2011) in which the FDIC is known to have received a VAI as part of the consideration paid by the buyer for a failed bank. Information regarding VAIs is not uniformly disclosed by the FDIC or buyers, including buyers that have publicly traded common stock.

CONCLUSIONS

VAIs have been used relatively infrequently. Only two were used in 2009, 17 in 2010, and five through April 29, 2011. The 24 VAI transactions are only 6.6 percent of the total bank failures during 2008 through May 2011. In the right situation, VAIs may be decisive or at least helpful in securing a winning bid in an FDIC-assisted transaction. The following should be considered:

- VAIs may be most useful in larger FDIC-assisted transactions or transactions that are strategically important to the bidders, especially blind pool-financed shelf charters that have a limited amount of time in which to invest their committed funds.

- VAIs may distinguish FDIC bidders and increase their chances of winning the bid in a deal where expansion outside of a FDIC-assisted transaction may be difficult for antitrust or other reasons, such as Banco Popular's successful FDIC-assisted acquisition of Westernbank PR. After the acquisition, Banco Popular had a deposit market share of 43.7 percent, substantially higher than the second biggest bank in Puerto Rico and greater than generally permissible for open bank transactions.

- VAIs add levels of complexity that may not be appropriate for small transactions, and small, nonpublic bank acquirers may find VAIs not very effective from either a cost or bid success standpoint.

- Small Bidders using the FDIC's VAI form will pay an alternate consideration fee in cash regardless of the performance of the buyer's stock. Although the buyer's tangible book value per share will depend, in part, upon the performance of the loss share assets acquired from the FDIC, much of the amount payable will depend on the performance of the Nasdaq Bank Index, which is unrelated to the buyer or its P&A transaction.

- Banks that are seeking to become public or contemplate a public offering in connection with a failed bank acquisition, especially where such an offering would increase the issuer's public float above $50 million, may find VAIs useful.

- As reflected by the FDIC preference for exercise periods of a year or longer, the shorter the period of the VAI, the less value and cost it has under a typical Black-Scholes valuation model. However, even VAI's with very short exercise periods can generate significant returns to the FDIC and costs to the buyer, as occurred in NYCB's acquisition of AmTrust Bank.

- The longer the term of the warrant, the potentially greater the cost and risk to the buyer.

- The effects of VAIs should be considered in light of the bidder's existing securities, including any limitations on issuance and contractual anti-dilution provisions.

In all cases, potential bidders in FDIC-assisted transactions should carefully consider, in advance of bidding, the cost of a VAI and the effects upon the buyer's pro forma balance sheets and income statements. Potential bidders also should consider with their investment bankers the market effects of a VAI, especially where an offering is contemplated, whether or not contingent upon success of the bid to be conducted. Appropriate disclosure of VAIs is also required by the SEC.

VALUE APPRECIATION INSTRUMENTS GRANTED TO THE FDIC IN FAILED BANK ACQUISITIONS

Failed Institution	Date of Failure	Buyer Bank/ Buyer Company	Description of VAI			
			Settlement	Period	Units	Exercise Price
BankUnited, FSB Coral Gables, Florida	5/21/2009	BankUnited BU Financial Holdings, LLC	Shares of Buyer Company	10 days following IPO or sale of Buyer Company within 10 years of acquisition	Determined based on warrant value versus IPO price per share	Par Value
AmTrust Bank Cleveland, Ohio	12/4/2009	New York Community Bank New York Community Bancorp, Inc.	Cash or Shares of Buyer Company Common Stock (1)	14 days	25 million	$12.33
Evergreen Bank Bellingham, Washington	1/22/2010	Umpqua Bank Umpqua Holdings Corporation	Cash	30 days	1.74 million	$13.68
Premier American Bank Miami, Florida	1/22/2010	Premier American Bank, N.A. Bond Street Management, LLC	Cash	Up to 10 years	50,000 shares	Undisclosed. Total cash payment to FDIC: not less than $1.0 million nor more than $3.5 million
Florida Community Bank Immokalee, Florida	1/29/2010	Premier American Bank, N.A. Bond Street Management, LLC	Cash	Up to 10 years	65,000 shares	Undisclosed. Total cash payment to FDIC: not less than $1.3 million nor more than $4.55 million
The Park Avenue Bank New York, New York	3/12/2010	Valley National Bank Valley National Bancorp	Cash	24 days	Determined by FDIC	$14.372
City Bank Lynnwood, Washington	4/16/2010	Whidbey Island Bank Washington Banking Company	Cash	60 days	1 million	$12.31
Innovative Bank Oakland, California	4/16/2010	Center Bank Center Financial Corporation	Cash	Undisclosed (2)	1 million	Undisclosed (2)
Wheatland Bank Naperville, Illinois	4/23/2010	Wheaton Bank & Trust Wintrust Financial Corporation	Cash	180 days	125,000 per transaction	$38.75 (3)
Lincoln Park SB Naperville, Illinois	4/23/2010	Wheaton Bank & Trust Wintrust Financial Corporation	Cash	180 days	125,000 per transaction	$38.75 (3)
Broadway Bank Chicago, Illinois	4/23/2010	MB Financial Bank, N.A. MB Financial, Inc.	Cash	60 days	100,000	$23.4315
CF Bancorp Port Huron, Michigan	4/30/2010	First Michigan Bank First Michigan Bancorp, Inc.	Undisclosed	Undisclosed	Undisclosed	Undisclosed
Eurobank San Juan, Puerto Rico	4/30/2010	Oriental Bank and Trust Oriental Financial Corporation	Cash	60 days	334,000	$14.95 (4)

Failed Institution	Date of Failure	Buyer Bank/ Buyer Company	Description of VAI			
			Settlement	Period	Units	Exercise Price
Westernbank PR Mayaguez, Puerto Rico	4/30/2010	Banco Popular de Puerto Rico Popular, Inc.	Cash	1 year	50 million	$3.43
Midwest Bank & Trust Co. Elmwood Park, Illinois	5/14/2010	FirstMerit Bank, N.A. FirstMerit Corporation	Cash	25 days	2.5 million	$22.81
Peninsula Bank Englewood, Florida	6/25/2010	Premier American Bank, N.A. Bond Street Management, LLC	Cash or Stock	2 years	65,000 shares	$20.00
Ravenswood Bank Chicago, Illinois	8/6/2010	Northbrook Bank and Trust Company Wintrust Financial Corporation	Cash	6 months	125,000	$33.00 (3)
Palos Bank & Trust Palos Heights, Illinois	8/13/2010	First Midwest Bank First Midwest Bancorp, Inc.	Cash	180 days	100,000	Undisclosed (5)
Hillcrest Bank Overland Park, Kansas	10/15/2010	Hillcrest Bank, N.A. NBH Holdings, Corp.	Undisclosed	Undisclosed	Undisclosed	Undisclosed
Legacy Bank Scottsdale, Arizona	1/7/2011	Enterprise Bank and Trust Enterprise Financial Services Corporation	Cash	51 weeks	372,500	$10.63 (6)
Community First Bank Chicago Chicago, Illinois	2/4/2011	Northbrook Bank & Trust Wintrust Financial Corporation	Cash	180 days	62,500	$34.00 (3)
Sunshine State Community Bank Port Orange, Florida	2/11/2011	Premier American Bank, N.A. Bond Street Holdings, Inc.	Cash or Stock	2 years	25,000	$19.68
The Bank of Commerce Wood Dale, Illinois	3/25/2011	Advantage National Bank Group Wintrust Financial Corporation	Cash	180 days	125,000	$34.00 (3)
First National Bank of Central Florida Winter Park, Florida	4/29/2011	Florida Community Bank, a division of Premier American Bank, N.A. Bond Street Holdings, Inc.	Cash or Stock	2 years	100,000	$19.66

(1) The FDIC exercised its rights under the VAIs, recognizing the largest gain on VAIs of any transaction since 2009 of approximately $23.3 million.

(2) Details of VAI terms are undisclosed, but Center Financial Corporation reported in its Quarterly Report on Form 10-Q filed on April 29, 2010, that the FDIC had exercised its rights under the VAIs granted in conjunction with the acquisition of Innovative Bank and realized a gain of approximately $1.4 million on April 26, 2010.

(3) The cash amount per unit paid to the FDIC upon exercise of the VAI was capped at $8.00 per unit.

(4) The FDIC opted not to exercise its rights under the VAIs, resulting in a favorable accounting adjustment for the Buyer Company in the amount of approximately $909,000.

(5) Exercise price was not disclosed, but the VAI was capped at 25 percent appreciation.

(6) The cash amount per unit paid to the FDIC upon exercise of the VAI was capped at $13.32 per unit.

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