



BROWN RUDNICK'S STRUCTURED RESOLUTION GROUP

# US TREASURY BAIL-OUT ALERT

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Is the Emergency Economic Stabilization Act of 2008 turning out to be the real deal? On the heels of yesterday's "Manic Monday," when the Dow Jones Industrial Average gained 936 points (nearly doubling the largest daily point gain in its history and recording the first 10+% gain since 1933), the Treasury today announced the details of its voluntary Capital Purchase Program "to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy." Under the program – governed by the bail-out legislation – the Treasury will take equity stakes in U.S. financial institutions by purchasing up to \$250 billion (out of the \$700 billion authorized by Congress) of senior preferred shares. The details of the government's investment, as outlined in the program's term sheet published by the Treasury, include the following:

- **Purchase of Equity:** Under the program, the Treasury will purchase senior preferred shares in financial institutions. Such shares will qualify as Tier 1 capital, will be senior to common stock and rank *pari passu* with the existing preferred shares (other than preferred shares that, by their terms, rank junior to any existing preferred shares). The subscription amounts of preferred shares available to each participating financial institution may vary between 1% of its risk-weighted assets and the lesser of \$25 billion and 3% of its risk-weighted assets. The purchasing transactions will be accomplished by year-end 2008.
- **Dividends and Restrictions:** Senior preferred shares will pay quarterly dividends at a rate of 5% per annum for the first five years following the investment, and a rate of 9% per annum thereafter. For as long as any of the senior preferred shares purchased by the Treasury remain outstanding, no dividends may be declared or paid on any junior shares unless all of the dividends due to the preferred shares are fully paid. The Treasury's consent will be required for any increase in common dividends prior to the third anniversary of the investment date.
- **Transferability, Repurchases and Redemptions:** There will be no contractual restrictions on the Treasury's right to transfer its preferred shares. Certain restrictions will be placed, and the Treasury's consent will be required for, repurchases of shares, including the preferred shares. Senior preferred shares will generally be redeemable *at par* after three years.

- **Voting Rights:** Senior preferred shares will not have voting rights other than with respect to certain issues and transactions affecting the rights of the senior preferred shares.
- **Executive Compensation:** Financial institutions participating in the Treasury program are required to adopt standards for executive compensation and corporate governance, as required by the Emergency Economic Stabilization Act of 2008 and as described below, with such updated standards to be applicable to the period during which the Treasury holds equity issued and purchased under this program.
- **Warrant Terms:** As part of the program, the Treasury will receive warrants to purchase common stock of the related financial institution with an aggregate market price equal to 15% of the amount of the senior preferred shares purchased by the Treasury on the investment date. The exercise price for the warrants will be the market price for the common stock on the investment date.
- **Eligibility:** The program will be available to banks, savings associations and other financial institutions organized under the laws of the United States, its states and territories. The Treasury will determine eligibility and allocation for specific financial institutions after consultation with the appropriate Federal banking agency. The deadline for electing to participate in the program is November 14, 2008.

The Treasury announced on Tuesday morning that nine large financial institutions have agreed to participate in the Capital Purchase Program. It has been reported that the large banks – including Citigroup, Wells Fargo, Goldman Sachs, Morgan Stanley, J.P. Morgan and Bank of America – were not very enthusiastic about the Treasury’s program but caved in to government pressure.

The Treasury has also provided further guidance with respect to the executive compensation rules under the Emergency Economic Stabilization Act. As outlined in our prior bail-out alerts, the legislation prohibits the participating financial institutions, which sell more than \$300 million of troubled assets to the Treasury, from entering into new executive employment contracts that include golden parachutes and, furthermore, places certain tax-related restrictions on executive compensation. The Treasury has also issued additional executive compensation guidelines applicable to the participants in the Capital Purchase Program described above. These include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of 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; (3) prohibition on the financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision; and (4) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive. The Treasury is also working on a separate set of compensation guidelines for systemically significant failing institutions.

In addition to the Capital Purchase Program, the government has announced several other measures intended to unequivocally calm the crisis affecting the financial



markets, after the initial plan to merely buy bad mortgages and related securities failed to restore investor confidence. Among the additional measures is the FDIC's move to expand the insurance provided to financial institutions by temporarily guaranteeing most new debt issued by covered banks, in an effort to jumpstart lending between banks. Under this initiative, most newly issued senior unsecured debt, including promissory notes, commercial paper, inter-bank funding and any unsecured portion of secured debt, issued on or before June 30, 2009, would be fully protected by the FDIC in the event of a subsequent bank failure. This coverage will expire on June 30, 2012. Moreover, the FDIC will also temporarily provide insurance on all deposits in non-interest bearing accounts without any amount limitations, in addition to the prior temporary increase to \$250,000 of FDIC deposit insurance. This initiative is aimed at addressing the concerns of many businesses worried about the lack of insurance on their payment-processing accounts, which tend to exceed the FDIC dollar limit. The government also announced the fees to be assessed on participating institutions, which include a 75-basis point fee for the protection of their new debt issuances, and a 10-basis point surcharge added to the bank's current insurance assessment.

The Department of Treasury has simultaneously continued to develop the framework to swiftly implement the Troubled Asset Relief Program ("TARP") approved by Congress 10 days ago. On Monday, the Treasury announced that Chicago-based Ennis Knupp and Associates was hired to serve as its investment adviser for the program's implementation. The firm immediately began its work of evaluating potential asset managers and other vendors, in addition to its other duties. The Interim Assistant Secretary, Neel Kashari, also announced other recruitments under the program, including Tom Bloom as the interim Chief Financial Officer, Jonathan Fiechter as interim Chief Risk Officer, Donna Gambrell as interim Chief of Homeownership Preservation, Don Hammond as interim Chief Compliance Officer and Reuben Jeffrey as interim Chief Investment Officer. On Tuesday afternoon, the Treasury announced that Bank of New York Mellon will serve as its custodian to help the Treasury with custodial, accounting, auction management and other infrastructure services needed to administer the complex portfolio of troubled assets to be purchased under the program. In addition to these recruitment efforts, the Treasury has moved to quickly establish the various oversight bodies established under the legislation, amongst which are establishing the Financial Stability Oversight Board and enabling physical presence of the General Accounting Office within the Treasury.

Finally, the Federal Reserve, invoking Depression-era emergency powers, also announced on Tuesday that it will begin purchasing considerable amounts of short-term debt on October 27<sup>th</sup>.

Whether these programs and initiatives, singly or collectively, play a positive role in thawing the credit markets and restoring confidence to equity markets is not certain; but there is no question that the government—including the champions of free-market capitalism—is willing and able to put ideology aside and take drastic steps to address the current crisis. Time will tell whether these steps are enough.



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