BANK REGULATORS WILL PERFORM A COORDINATED FORWARD-LOOKING CAPITAL ASSESSMENT, OR “STRESS TEST,” TO DETERMINE WHETHER ANY PARTICIPATING INSTITUTION NEEDS TO ESTABLISH AN ADDITIONAL CAPITAL BUFFER TO WITHSTAND POTENTIAL LOSSES CAUSED BY A SIGNIFICANT WORNSING OF THE ECONOMY. SECOND, ANY ELIGIBLE INSTITUTION THAT FAILS THE STRESS TEST WILL BE REQUIRED TO EITHER RAISE ADDITIONAL PRIVATE CAPITAL OR TO OFFER MANDATORILY CONVERTIBLE PREFERRED SHARES TO TREASURY.

Each of the 19 U.S. banking institutions that has consolidated assets exceeding $100 billion will be required to participate in the stress tests and may access the CAP immediately as a means to establish any required additional capital buffer. Any U.S. banking institution with consolidated assets below $100 billion will be able to participate voluntarily in the CAP, as long as it is a “Qualified Financial Institution” (QFI) and is “publicly traded.”

A QFI is any of the following:

1. A U.S. bank or U.S. savings association that is not controlled by a bank holding company (BHC) or a savings and loan holding company (SLHC).
2. A top-tier U.S. BHC.
3. A top-tier U.S. SLHC engaging solely or predominately in activities that are permitted for financial holding companies under relevant law.


STRESS TESTS

To receive capital injections from Treasury pursuant to the CAP, each participating QFI will be subjected to a one-time stress test by banking supervisors to estimate expected losses at that QFI over the next two years, assuming a “baseline” economic scenario and a more severe “adverse” scenario. The baseline scenario assumptions are based on the average of the economic projections published in February 2009 by Consensus Forecasts, the Blue Chip survey, and the Survey of Professional Forecasters. Under this scenario, it is assumed that (1) GDP will decline 2% in 2009 and increase 2.1% in 2010, (2) unemployment will be 8.4% in 2009 and 8.8% in 2010, and (3) housing prices will fall 14% in 2009 and 4% in 2010.

The adverse scenario reflects a deeper and longer recession than in the consensus baseline, and under that scenario, it is assumed that (1) GDP will fall 3.3% in 2009 and rise only 0.5% in 2010, (2) unemployment will be 8.9% in 2009 and be 10.3% in 2010, and (3) housing prices will decline 22% in 2009 and 7% in 2010.

Supervisors will use the results of the stress tests to determine the amount of additional capital, if any, that the QFI needs to be able to continue lending and to absorb the potential losses that could result from a more severe decline in the economy than projected. Each QFI will have six months to raise that capital from private sources, but to the extent that it is unable to do so, it will be required to access the capital by offering mandatorily convertible preferred shares exchange and (2) that is required to file periodic reports with the SEC or its primary federal bank regulator.

TREASURY’S NEW CAPITAL ASSISTANCE PROGRAM TO “STRESS TEST” AND PROVIDE BILLIONS TO BANKS

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THE CAPITAL ASSISTANCE PROGRAM WILL AGAIN MAKE BILLIONS OF DOLLARS OF CAPITAL AVAILABLE TO BANKS AND THRIFTS THAT NEED OR WANT TO BOLSTER THEIR CAPITAL RATIOS.

On February 25, 2009, the U.S. Department of the Treasury (Treasury) took action again to make billions of dollars of capital available to banks and thrifts that need or want to bolster their capital ratios. The new program, known as the Capital Assistance Program (CAP), is in addition to the Capital Purchase Program (CPP) whereby Treasury has provided almost $200 billion to U.S. financial institutions since October 2008. The CAP consists of two core elements. First, although details of any completed transaction will be published. If requested by a QFI, Treasury may allow certain portions of any application to be treated confidentially.

1 Guidelines for the program are available on Treasury’s website, www.treasury.gov/press/releases/tg40.htm, and include a white paper, a term sheet, and answers to a set of frequently asked questions.
2 “Publicly traded” means a company (1) whose securities are traded on a national securities exchange and (2) that is required to file periodic reports with the SEC or its primary federal bank regulator.
3 Treasury will not release the names of QFIs that apply for the CAP or those not approved.
ible, cumulative preferred shares (Convertible Preferred) to Treasury.4

TERMS OF CONVERTIBLE PREFERRED SHARES

The six main terms of the Convertible Preferred to be issued to Treasury pursuant to the CAP are examined below.

1) Each QFI may issue and sell to Treasury Convertible Preferred in an amount equal to not less than 1% of its risk-weighted assets and not more than 2% of its risk-weighted assets plus any additional amount of Convertible Preferred to the extent that the additional proceeds are used to redeem preferred shares sold under the CPP or Treasury’s Targeted Investment Program.5

2) The Convertible Preferred will mandatorily convert to common stock at the “Conversion Price” after seven years, and optional conversion may occur earlier at the option of (a) the QFI at any time, with approval of the QFI’s primary federal banking agency, and (b) the Convertible Preferred holder on specified significant corporate events (including certain sales, mergers, or changes in control of the QFI.) The Conversion Price is 90% of the average closing price for the QFI’s common stock for the 20-trading-day period ended February 9, 2009, subject to (a) customary anti-dilution adjustments and (b) three successive penalty reductions, each of 15% of the initial Conversion Price, on the six-, 12-, and 18-month anniversaries of the issue date if any needed stockholder approval to authorize QFI common shares underlying the Convertible Preferred or the warrants (described below) has not been obtained by those anniversaries.

3) The Convertible Preferred will have a cumulative dividend rate of 9% a year, compounding quarterly, but the rate will balloon to 20% if certain required stockholder approvals are not received within six months.

4) The Convertible Preferred will be entitled to Tier 1 regulatory capital status and will rank senior to common stock and pari passu with existing preferred shares other than those that, by their terms, rank junior to any existing preferred shares.

5) The Convertible Preferred will be non-voting (except for class voting rights on authorizing or issuing shares ranking senior to the Convertible Preferred, amendments to the rights of the Convertible Preferred, or significant matters such as mergers that would adversely affect the rights of the Convertible Preferred). However, if dividends are not paid in full on the Convertible Preferred for six dividend periods, whether or not consecutive, the holders of the Convertible Preferred will have the right to elect two directors, a right that will end when full dividends have been paid for four consecutive periods. Also, on conversion of the Convertible Preferred, Treasury will have the voting rights of the QFI’s common stock.

6) The issuance by a QFI of the Convertible Preferred will qualify as a “Qualified Equity Offering” under the CPP if the proceeds from the sale of the Convertible Preferred redeem the old preferred shares and warrants issued under the CPP.

RESTRICTIONS ON REDEMPTIONS, DIVIDENDS, AND RE-PURCHASES

There are restrictions on redemptions, dividends, and repurchases.

Redemptions

At any time, Convertible Preferred may be wholly or partially redeemed, with the QFI’s primary federal banking agency’s consent, solely with the proceeds of one or more issuances of common stock for cash that results in aggregate gross proceeds to the QFI of not less than 25% of the issue price of the Convertible Preferred or additions to retained earnings. Convertible Preferred redeemed within the first two years of issuance are redeemable at par, plus any accrued and unpaid dividends, and afterwards, at the greater of par plus accrued and unpaid dividends and the as-converted value. After the redemption in whole of the Convertible Preferred held by Treasury, a QFI may repurchase the warrant and any common stock then held by Treasury at fair market value.

Dividends on Junior Securities

For as long as any Convertible Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Convertible Preferred, or common shares; nor may the QFI repurchase or redeem any of those shares, unless all accrued and unpaid dividends for all past dividend periods on the Convertible Preferred are fully paid.

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4 A QFI may apply for CAP funds from Treasury immediately at the conclusion of the stress test to be certain of its access to Treasury funds, but then delay funding for six months to have as much opportunity to raise private funds as possible.

5 A QFI may issue Convertible Preferred exceeding the investment limit with the approval of the appropriate federal banking agency, but it would then be deemed to require “exceptional assistance,” which would restrict even further the form and amount of executive compensation permitted for that QFI. Treasury, in its sole discretion, but in consultation with the appropriate federal banking agency, will determine whether to provide that “exceptional assistance.”

6 However, pari passu preferred shares may receive dividends pro rata with the Convertible Preferred.
Also, for as long as any Convertible Preferred or common stock of the QFI issued under the CAP is outstanding and owned by Treasury, dividends declared and paid on the common stock may not exceed $0.01 per share per quarter without Treasury’s consent.

Repurchases

For as long as any Convertible Preferred or common stock issued under the CAP is outstanding and owned by Treasury, any repurchases of equity securities or trust preferred securities will require Treasury’s consent (subject to certain exceptions similar to those for the CPP). In addition, there will be no share repurchases if prohibited as described in the paragraph above.

MANDATORY SALE

After the mandatory conversion date, Treasury will make reasonable efforts to sell annually common stock equal to at least 20% of the total common stock owned by it on the mandatory conversion date until it owns none of the QFI’s common stock. After the conversion of the Convertible Preferred into the QFI’s common stock, the QFI may, with its primary federal banking agency’s consent, repurchase any common stock held by Treasury at a price equal to the greater of the Conversion Price and the market price of the common stock on the date of repurchase.7 Any of these repurchases must be made with the proceeds of an issuance of common stock for cash or additions to retained earnings. Afterwards, the QFI may repurchase the warrants (described below) (and any common stock issued on their exercise) then held by Treasury at fair market value.

WARRANT TERMS

Treasury will also receive warrants (Warrants) to purchase common stock of the QFI with an aggregate market value equal to 20% of the aggregate redemption price of its Convertible Preferred on the date of investment. The initial exercise price for the Warrants will be the Conversion Price, subject to the same three penalty reductions for delayed stockholder approval as the Convertible Preferred Conversion Price penalty reductions described above.

The Warrants will have a term of ten years and be immediately exercisable and fully transferable. If Treasury exercises the Warrants, it will agree not to vote the common stock it receives in connection with that exercise.

If the QFI’s common stock is no longer listed or traded on a national securities exchange, or any required approval of the QFI stockholders has not been received within 18 months after the issuance date of the Warrants, the Warrants will be exchangeable at Treasury’s option for senior-term debt or another economic instrument of the QFI. If the QFI does not have enough available authorized shares of common stock to reserve for issuance on conversion of the Convertible Preferred and exercise of the Warrants or stockholder approval is required for that issuance under applicable stock exchange rules (or both), the QFI will call a meeting of its stockholders as soon as practicable after the date of a CAP investment to increase the number of authorized shares of common stock or comply with the exchange rules (or both) and take any other measures deemed necessary by Treasury to convert the Convertible Preferred or exercise the Warrants.

TRANSFERABILITY OF PREFERRED SHARES, WARRANTS, AND UNDERLYING COMMON STOCK

None of the Convertible Preferred, the Warrants, or the underlying common stock of the QFI will be subject to any contractual restrictions on transfer. Each QFI will be required to file a shelf registration statement covering the Convertible Preferred, the Warrants, and the common stock underlying the Warrants as promptly as practicable after the date of investment, and if necessary, take all action to cause those shelf registration statements to be declared effective as soon as possible. Moreover, each QFI will grant to Treasury piggyback registration rights for the Convertible Preferred, the Warrants, and the underlying common stock; apply to list the underlying common stock on the same national securities exchange as the QFI’s common stock; and take other reasonable steps requested by Treasury to facilitate transfer of those shares.

EXECUTIVE COMPENSATION

Each QFI and its covered officers and employees will be subject to the rules, regulations, and guidance of Treasury with respect to executive compensation, transparency, accountability, and monitoring, as published and in effect at the time of the investment closing. These rules include the executive compensation restrictions imposed by the Emergency Economic Stabilization Act of 2008 (EESA), as amended by the American Recovery and Reinvestment Act of 2009 (ARRA) that was signed into law by Presi-
dent Obama on February 17. These rules are broad and comprehensive and include:

1. Restrictions on bonuses and incentive compensation.
2. Prohibitions on certain severance payments.
3. Recoupment of certain bonus and incentive compensation.
4. Limits on incentives for excessive risk taking.
5. Limits to deductions for compensation.
6. Requirements regarding luxury expenditures.
7. Provisions regarding stockholder “Say-on-Pay.”
8. Requirements to provide compliance certifications regarding all of the foregoing items.

These rules may require modification or waivers of existing contracts and severance arrangements, and are subject to further change by Treasury. Treasury is expected to issue shortly specific rules implementing the recent amendments by the ARRA to EESA, which would be applicable to the CAP.

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