HUNTON & WILLIAMS

CLIENT ALERT

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Peter Weinstock
1445 Ross Avenue Suite 3700
Dallas, TX 75202-2799
(214) 468-3395
pweinstock@hunton.com

Chet Fenimore
111 Congress Avenue
Suite 1800
Austin, TX 78701
(512) 542-5004
cfenimore@hunton.com

Application Guidelines for TARP Capital Purchase Program

Upon first blush, the application for the Treasury Capital Purchase Program (CPP) under the Troubled Assets Relief Program (TARP) looks straightforward. The form itself is only two pages. Moreover, companies in addition to the first nine applicants have been receiving funding. Is the process really a slam-dunk?

For financial institutions that are healthy public companies, the process appears to be relatively straightforward. For others, however, that:

- are CAMELS 3, 4 or 5 rated;
- are subject to administrative actions;
- are thrift institutions that are being held to a higher standard by the OTS;
- are nonpublic (for which changes to the CPP tailored to such companies have not yet been promulgated); or
- desire to enhance their prospects,

we recommend the application be accompanied by a cover letter or attachments that either address or flesh out the following points:

1. Use of Proceeds.

The Emergency Economic Stabilization Act of 2008 (EESA) sets forth that the purposes of the funding provided by Congress are, among other things, to:

- Protect home values, college funds, retirement accounts and life savings;
- Preserve home ownership; and
- Promote jobs and economic growth.

Recently, Congress and various interest groups have criticized the Department of the Treasury, asserting that the intention of the statute is being subjugated. The capital that is being allocated to financial institutions is being used for acquisitions. Some financial institutions have not reduced or eliminated their dividend despite having received the senior preferred. Other financial institutions have used the capital to shore up weakness in their balance sheet. Perhaps the most vocal and influential critic has been Sheila Bair, the chairman of the Federal Deposit Insurance Corporation, who has voiced her frustration that more is not being done to restructure mortgages.

The Treasury, as is the case with any federal agency, is not immune from such criticism. For financial institutions that are more marginal applicants for senior preferred, it is worthwhile to include in their application a discussion of how they will use the funds to meet the purposes of the EESA.

2. Viability.

The EESA makes clear that the Treasury must consider "the long-term viability of the financial institution in determining whether the purchase represents [the] most efficient use of funds …." The Treasury has stated that it will make such a determination upon consultation with the primary federal bank regulator of a financial institution. Accordingly, it is critical that a financial institution demonstrate that it will not be just "viable," but also satisfactory from a safety and soundness standpoint if it receives the senior preferred.

Financial institutions should make such a showing in a manner typical of a capital plan deemed to be acceptable to bank regulators under the prompt corrective action ("PCA") regime. Thus, the submission should include the following (either with their application or supplementally):

- **Asset Quality.** A discussion of asset quality, including plans to resolve classified assets and nonperforming assets. The financial institution might consider addressing the asset quality issues in an independent attachment that is provided to the banking regulators alongside the submission to the Treasury.
- **Earnings.** The submission should demonstrate that the financial institution will not just become profitable as a result of the senior preferred, but will generate sufficient profits to service the dividend on the senior preferred.

  The senior preferred is cumulative. Accordingly, the government is protected if a financial institution misses dividend payments in 2009. Nonetheless, it is important to show that the financial institution will be able to service the preferred stock dividend. Again, a financial institution might consider including projections, which are a key part of a PCA capital plan.
- **Pro Forma Capital Ratios.** We understand that some of the regulatory agencies are requesting that CPP applicants provide pro forma capital ratios, giving effect to the issuance of the senior preferred securities.

3. Private Capital.

The EESA states that the Treasury "shall encourage the private sector to participate in purchases of troubled assets, and to invest in financial institutions …." Private capital speaks volumes to the government regarding viability. If a financial institution is able to bring outside funding or capital to the table, it will serve as a Good Housekeeping Seal of approval on the submission.

Even if an institution does not have private capital lined up it should discuss its plans for raising capital. Any assurances from investment bankers or otherwise that an institution can provide will be useful in this regard. The TARP specifically provides that the warrants issued to the government will be cut in half if private capital is raised before the end of 2009. Plans for doing so should be detailed.

4. Mergers and Acquisitions.

The Treasury has indicated that it wants to encourage mergers whereby recipients of senior preferred acquire troubled financial institutions. The recent activity and rumblings in the market seem to bear this out. In fact, the deciding factor in National City's discussion about merging with PNC may have been that the Comptroller of the Currency advised National City that it would not be approved for any senior preferred under the TARP. The applicant should discuss if it will be acquiring a problem institution. Likewise, if a bank is currently in the process of completing an acquisition, both the acquirer and acquiree can apply to participate in the CPP and receive up to three percent of their respective risk-weighted assets.

5. Unresolved Conditions.

The financial institution must explain why it cannot meet any condition or comply with any representation or warranty in the agreements or instruments with the Treasury. It must also submit a timetable setting forth when compliance will be achieved.

6. Confidentiality Concerns

Applicants should ask for confidential treatment for much of the information recommended above. We also recommend asking for confidential treatment of any draft application that is submitted (although regulatory authorities may give draft applications confidential treatment without a specific request). To request confidential treatment, each applicant should enclose a separate letter with the application, identifying the portions of the application for which confidential treatment is sought and the justification for requesting confidential treatment. The justification may include loss of competitive advantage if the information is made public. Confidential portions of the application should also be separately bound and labeled "Confidential."

7. Timing and Submission of the Application.

The deadline to apply for the CPP is 5:00 p.m. E.S.T. on November 14, 2008. While there is no requirement to file an application before the deadline, we believe that all eligible institutions that are considering participating in the CPP should begin dialogue with their regulators and consider submitting a draft application as soon as possible. This is true for both publicly traded banks and non-publicly traded banks (including subchapter S banks and bank holding companies) even though the terms of private bank participation in the CPP have yet to be released. Beginning the process early will position the bank to make any necessary adjustments or provide any additional supplemental information required by the regulators to favorably act on the CPP application. Even after approval, applicants may withdraw the application if they later decide not to participate in the program for any reason.