

# TARP Capital Exit Strategy (CaPP Public Institutions\*)

## Summary: Exiting the Treasury capital investment under the Capital Purchase Program (does not address Capital Assistance Program)

- Capital Purchase Program participants sold senior preferred stock and issued warrants to Treasury
- Repurchase by issuers of these securities is:
  - governed by contracts with Treasury *and*
  - subject to the Emergency Economic Stabilization Act of 2008 (Stabilization Act) *and*
  - subject to the American Recovery and Reinvestment Act of 2009 (Recovery Act)
- The American Recovery and Reinvestment Act (Recovery Act) amends provisions of the Emergency Economic Stabilization Act (Stabilization Act) applicable to the Capital Purchase Program – but Treasury has provided very limited information on the new law

\* NOTE: warrants issued by private institutions were immediately exercised by Treasury

### Exiting - Defined

- Preferred stock must be repurchased from Treasury, or Treasury must transfer 100% of the preferred stock *and*
- Repurchase other CaPP securities from Treasury, or Treasury must transfer 100% of the other securities:
  - Warrants must be repurchased (or transferred)
  - If warrants have been exercised, common stock must be repurchased (or transferred)

### Impact of Repurchases

- Repurchase of 100% of preferred stock
  - Terminates limits on dividends, repurchases of other securities, Treasury's right to board seats
  - Permits repurchase of warrant (or common stock if Treasury has exercised the warrant)
  - Impact on executive compensation unclear – see below
  - Registration rights for warrants (and underlying common stock) remain
- Repurchase of 100% preferred stock and 100% warrant/common stock terminates all obligations to Treasury under the agreements

### Repurchasing Senior Preferred

- **Important Note:** The Recovery Act changed the terms of the CaPP contracts
- **Recovery Act:** Request permission from primary federal banking regulator to repurchase senior preferred securities; regulator will work with Treasury
- **Contract requires:**
  - Within the first 3 years: with consent of primary federal banking regulator issuers may repurchase with proceeds from a “qualified equity offering”
  - qualified equity offering: sale of preferred or common stock qualifying as Tier 1 capital, in cash transaction with non-affiliate; proceeds must be no less than 25% of senior preferred investment amount
- **After 3 years:** May repurchase any amount of senior preferred at any time, with consent of primary federal banking regulator

### Repurchasing the Warrant – Contract Terms

- After redeeming all of the senior preferred, issuer can repurchase all or some of the other equity securities (warrants or common stock) at “fair market value”
- NOTE: After senior preferred is repurchased in full, Treasury will seek to “liquidate” its warrant/common stock investment as soon as practicable; anticipated to be sales by Treasury; issuers seeking control over distribution of their securities should plan on repurchasing both preferred stock and warrants/common stock at the same time
- Fair Market Value:
  - Determined in good faith by the issuer's board based on an opinion of an independent investment bank (“independent” should exclude affiliates)
  - If Treasury disagrees with valuation, it may object and parties must meet to agree upon fair market value within 10 days of Treasury receiving board's determination
  - If no agreement, then appraisal procedure is implemented
  - Contracts define “market value” for purposes of certain registration rights – for common stock as its market price and for the warrants as the common stock price less exercise price – this may be helpful in determining fair market value
- Appraisal procedure:
  - Two independent appraisers (one chosen by each party) agree on fair market value
  - If unable to agree in 10 days, a third appraiser is chosen with mutual consent of two original appraisers
  - Average of three will be binding (outlier value, as determined by contract, will be excluded)
  - Issuer pays for appraisers

NOTE: If issuer receives proceeds from qualified equity offering of at least 100% of liquidation preference of preferred stock before 12/31/09, then the number of shares of common stock underlying warrant is automatically reduced by half – thereby reducing the amount needed to be repurchased to exit the program

### Considerations

- Consultation with federal banking regulators is required (and recommended) as part of exit strategy
- Consider accounting impacts: SEC and FASB permitted warrants to be recorded as equity
- Regulatory capital / rating agency treatment: Although Treasury preferred stock was accorded Tier 1 treatment, rating agencies gave only partial equity credit; replacement Tier 1 transactions would be regulatory capital neutral but improve rating agency treatment
- Replacement common stock – also would be regulatory capital neutral but improve both rating agency treatment and tangible common equity ratios
- Qualified equity offerings must be either common stock or preferred stock & Tier 1: mandatory convertible debt issued under the FDIC's TLGP would not be eligible

### Redeeming Preferred Securities Issued under the CaPP

- Treasury announced additional guidance on May 6, with the supervisory capital assessment program results (SCAP - formerly known as stress tests)
- Banking supervisors will evaluate requests to repurchase CaPP securities:
  - Carefully weigh desire to redeem outstanding CaPP preferred stock against the contribution of Treasury capital to the institutions overall soundness, capital adequacy, and ability to lend, including confirming that BHCs have a comprehensive internal capital assessment process.
- All BHCs seeking to repay CaPP will be subject to the existing supervisory procedures for approving redemption requests for capital instruments.
- The 19 BHCs that were subject to the SCAP process must have a post-repayment capital base at least consistent with the SCAP buffer, and must be able to demonstrate its financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of government guarantees.