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U P D A T E

News of Developments in the Financial Sector and Related Areas

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The Treasury Capital Purchase Program

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The U.S. Treasury created the Capital Purchase Program ("CPP") in October 2008 to stabilize the financial system by providing capital to viable financial institutions of all sizes throughout the United States. Through the CPP program, the Treasury is investing up to $250 billion in banks in the United States that are healthy but desire an extra layer of capital for stability or lending. Under the CPP program, the Treasury provides capital to viable financial institutions through the purchase of senior preferred shares and senior subordinated debentures on standardized terms which include warrants for Treasury purchases of common stock and debentures.

The Treasury Department has designed a program to allow participation through the issuance of senior subordinated debentures by Subchapter S corporations. The interest rate on the senior subordinated debentures carry a higher interest rate since the interest payments can be deducted for tax purposes while dividend payments on the preferred shares cannot be deducted.

On May 22, 2009, the Federal Reserve Board announced the adoption of a final rule that will allow the preferred stock issued to the Treasury Department to be included in tier 1 capital without any restriction. Bank holding companies that are Subchapter S corporations may also count the senior subordinated debt issued to the Treasury as tier 1 capital without any restrictions.

Recently, the Treasury Department announced an extension of the CPP program for small banks. Banks with less than $500 million of total assets are eligible to apply for up to 5% of their risk weighted assets. The application deadline for filing by a small bank is November 21, 2009. The application process for new applicants is the same as the original CPP application process. For those banks that are already a participant in the CPP program, the Treasury is establishing an expedited application process. The bank will need to fill out the original application which will be posted on all four of the federal banking agencies' websites. Existing participants should apply through both their primary and holding company regulator, if applicable. These agencies will evaluate the application and make a recommendation to the Treasury.

An existing participant in the CPP program must be current on dividend payments in order to qualify for additional funds. Participants that have issued cumulative preferred must not have any deferred dividends, and participants that issued non-cumulative preferred must have paid a dividend for the most recent period.

For those institutions that have received preliminary approval from the Treasury and have not yet completed the transaction, they are eligible to apply for the additional funds up to a maximum of 5% of risk weighted assets. For those institutions in this situation, they should notify the Treasury via CPP@do.treas.gov and their primary federal banking regulator. For those applicants that have submitted an application for funds under the original program and have not yet received preliminary approval from the Treasury, they should contact their primary federal banking regulator to increase their application for the additional funds. Those institutions that have been preliminarily approved, but have not had their transaction funded, can contact the Treasury directly to increase their request to 5% of risk weighted assets.

It is important to note that small banks under this program will only be required to issue warrants for the first 3% of the Treasury's CPP investment and not any incremental investment. Institutions have six months from the date of preliminary approval, but in no event later than December 31, 2009, to enter into a binding Letter Agreement with the Treasury to fund the transaction. Banks may redeem the CPP investment at any time irrespective of those terms specified in the original transaction documents. A bank desiring to redeem its investment should contact its primary regulator and notify the Treasury at CPP@redemption@do.treas.gov. Details of the redemption and completion of all necessary documentation will be handled by the original Treasury Department attorney.

Participants in the CPP program wishing to repay part of its CPP investment may pay a minimum of 25% of the issue price of the securities. A participant may also purchase the warrants at the time of redemption. At the time of redemption a participant must pay any accrued and unpaid dividends.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 ("The Stimulus Bill") was signed into law. One significant area covered in The Stimulus Bill is the restrictions on executive compensation by institutions who receive funding under the Treasury CPP program. The restrictions prohibit the payment or accrual of bonus, retention and incentive compensation of any kind, other than restrictive stock awards (stock awards are also subject to specific limitations), except for payments made pursuant to a written employment agreement executed on or before February 11, 2009. The Treasury has up to one year before issuing final rules for implementing the legislation. Employees covered by the restrictions are as follows:

- Less than $25 million - the single most highly compensated employee.
- $25 million but less than $250 million – the five most highly compensated employees.
- $250 million but less than $500 million – essentially the top five senior executive officers plus the next ten most highly compensated employees.
- $500 million or more – essentially the top five senior executive officers plus the next twenty most highly compensated employees.

Except for nonpublic companies that receive less than $25 million in funds, financial institutions must have a Board Compensation Committee comprised entirely of independent directors. The Stimulus Bill also requires a shareholder vote on a nonbinding advisory basis to approve executive compensation.

In connection with participating in the CPP program, it is important to work with legal counsel who has experience in this area. Our firm has experience in representing financial institutions in the CPP program, and is available to assist and answer questions.