

CORPORATE AND SECURITIES LAW

Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Treasury Announces Terms of TARP Capital Purchase Program Applicable to Non-Public Qualifying Financial Institutions

November 18, 2008

On November 17, 2008, the United States Treasury issued a [Summary Term Sheet](#) and set of [Frequently Asked Questions](#) related to the Treasury's TARP Capital Purchase Program applicable to qualifying financial institutions which are not publicly traded and are not S Corporations or Mutual Depository Institutions. Set forth below is a short summary, in question and answer format, of the material terms of the program.

What entities qualify as “qualifying financial institutions” for purposes of participating in the Treasury program applicable to non-public qualifying financial institutions announced on November 17, 2008?

Banks and bank holding companies and savings and loan associations and savings and loan association holding companies that are (1) not publicly traded¹ and (2) not S Corporations or Mutual Depository Institutions. For purposes of the program applicable to non-publicly traded qualifying financial institutions, “publicly traded” means a company (1) whose securities are traded on a national securities exchange and (2) is required to file, under the securities laws, periodic reports such as the annual (Form 10-K) and quarterly (Form 10-Q) reports with either the Securities and Exchange Commission or its primary federal bank regulator. SEC filers whose stock trades on the OTC Bulletin Board, Pink Sheets or in the local community are not “publicly traded.”

What is the deadline for applying for participation in the program?

Applications must be filed by December 8, 2008.

Are S corporations or Mutual Depository Institutions allowed to participate in the program applicable to non-public qualifying financial institutions?

No. These structures are still under consideration and the December 8, 2008 deadline does not apply to these entities.

What type of securities will participating qualifying financial institutions have to issue to the United States Treasury?

Treasury will acquire preferred stock in an amount equal to not less than 1% of the qualifying financial institution's risk-weighted assets and not more than the lesser of (1) \$25 billion and (2) 3% of the institution's risk-weighted assets. The preferred stock will have a liquidation preference of \$1,000 per share, which may be higher if the institution does not have sufficient authorized but unissued shares of preferred stock. The preferred shares will rank senior to the institution's common stock and *pari passu* with its existing preferred shares, other than preferred shares which by their terms rank junior to any existing preferred shares.

In addition to the preferred shares, qualifying financial institutions, which are not Community Development Financial Institutions that sell less than \$50 million of preferred shares to Treasury, must also issue Treasury warrants to purchase, upon net settlement, a number of net shares of preferred stock (the "Warrant Preferred") having an aggregate liquidation preference equal to 5% of the total amount of the preferred shares sold to Treasury. The initial exercise price of these warrants will be \$0.01 per share or such greater amount as the institution's charter may require as the par value of the Warrant Preferred.

What is the dividend rate payable on the preferred stock that will initially be issued to Treasury?

The preferred shares will pay a cumulative (non-cumulative in the case of qualifying financial institutions that are banks which are not subsidiaries of bank holding companies) dividend at the rate of 5% per annum until the fifth anniversary of the date of the initial investment. Thereafter, the dividend rate will be 9%. Dividends will be payable quarterly in arrears on February 15, May 15, August 15, and November 15 of each year.

When can the preferred shares be redeemed?

The preferred shares may not be redeemed for a period of three years from the date of the initial investment, except with the proceeds of a qualified equity offering which results in aggregate gross proceeds to the institution of not less than 25% of the issue price of the preferred shares. After the third anniversary, the preferred shares can be redeemed, in whole or in part, at any time at the institution's option.

A "qualified equity offering" means the sale by the institution after the date of the initial investment by Treasury of Tier 1 qualifying perpetual preferred stock or common stock for cash other than sales made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008.

What are the restrictions on a participating qualifying financial institution's ability to pay dividends?

For as long as the preferred shares initially issued to Treasury are outstanding, a qualifying financial institution participating in the program can not declare or pay any dividends on preferred shares ranking junior or *pari passu* with Treasury's preferred shares or on common

shares unless all accrued and unpaid dividends for all past dividend periods (or the most recent dividend period in the case of non-cumulative preferred shares issued by banks that are not subsidiaries of a bank holding company) have been declared and paid in full.

Must a participating qualifying financial institution receive the consent of Treasury to pay dividends?

Although Treasury's consent is initially not required for the institution to pay dividends on common shares, Treasury's consent must be obtained to increase common dividends prior to the third anniversary of the date of Treasury's initial investment.

After the third anniversary, but prior to the tenth anniversary, if Treasury still holds any of the preferred shares or Warrant Preferred, Treasury's consent is required for any increases in aggregate common dividends per share which in the aggregate are greater than 3% of the amount of the dividends paid in the prior year. However, no increase in dividends may be made during the period between three and ten years as a result of any dividend paid in common shares, any stock split or similar transaction.

From and after the tenth anniversary of the date of Treasury's initial investment, a participating qualifying financial institution is prohibited from paying any common dividends until all equity securities (including the Warrant Preferred) are redeemed in whole or Treasury has transferred all of the equity securities held by it to third parties.

What are the restrictions on a participating qualifying financial institution's ability to repurchase its outstanding securities?

For as long as the preferred shares initially issued to Treasury are outstanding, a qualifying financial institution participating in the program can not repurchase or redeem preferred shares ranking junior or *pari passu* with Treasury's preferred shares or common shares unless all accrued and unpaid dividends for all past dividend periods (or the most recent dividend period in the case of non-cumulative preferred shares issued by banks that are not subsidiaries of a bank holding company) have been declared and paid in full.

Must a participating qualifying financial institution receive the consent of Treasury to repurchase any of its outstanding securities?

Until the tenth anniversary of the date of Treasury's initial investment, Treasury's consent is required for any repurchases of equity securities or trust preferred securities, other than repurchases of the preferred shares initially purchased by Treasury and repurchases of preferred stock ranking junior to the preferred stock purchased by the Treasury or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice. Treasury's consent is not required if the preferred shares initially purchased by Treasury and the Warrant Preferred are redeemed in whole or Treasury has transferred all of the preferred shares and the Warrant Preferred to third parties.

Will the preferred shares have voting rights?

The preferred shares will be non-voting, other than class voting rights on any authorization or issuance of shares ranking senior to the preferred shares held by Treasury; any amendment to the rights of the preferred shares held by Treasury; and any merger, exchange or similar transaction which would adversely affect the rights of the preferred shares held by Treasury.

Can the preferred shares held by Treasury be transferred?

Yes, the preferred shares are freely transferable with the exception that Treasury and its transferees can't transfer the preferred shares if the transfer would require the qualifying financial institution to be subject to the periodic reporting requirements of the Securities Exchange Act. If the institution otherwise becomes subject to these reporting requirements, it must file a shelf registration statement covering the preferred shares as promptly as practicable and take all action necessary to cause the registration statement to be declared effective. Since existing SEC filers are already subject to these reporting requirements, it is possible they will have to file such a shelf registration, although the issue is not definitively addressed in Treasury's term sheet. The stock purchase agreement for "publicly traded" financial institutions did not require a shelf registration if the institution was not S-3 eligible (i.e. was not traded on a national securities exchange). Treasury, and its transferees, will also have piggyback registration rights.

Will there be any limits on executive compensation?

Non-public qualifying financial institutions will be subject to the same limitations on executive compensation as publicly traded qualifying financial institutions. This means that, among other things, while Treasury owns debt or equity securities issued by the qualifying financial institution in connection with the program, the institution must:

- ensure that the incentive compensation programs for its senior executive officers do not encourage unnecessary and excessive risks that threaten the value of the institution;
- implement a required clawback of any bonus or incentive compensation paid to the Company's senior executive officers based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate;
- not make any "golden parachute payment" (as defined in the Internal Revenue Code) to any of the Company's senior executive officers; and
- agree not to deduct for tax purposes executive compensation in excess of \$500,000 in any one fiscal year for each of the Company's senior executive officers.

Are there any limits on related party transactions?

Yes, for as long as Treasury holds any equity securities of the qualifying financial institution, the institution and its subsidiaries can not enter into transactions with related parties (as defined in

the SEC's rules) unless (1) the transactions are on terms no less favorable to the institution and its subsidiaries than could be obtained from an unaffiliated third party; and (2) the transactions have been approved by the institution's audit committee or comparable body of independent directors of the institution.

What is the term of the warrants?

The warrants have a ten year term.

When can Treasury exercise the warrants?

Treasury can exercise the warrants immediately and the term sheet indicates that Treasury intends to exercise the warrants immediately.

What is the exercise price of the warrants?

The warrants must have an exercise price equal to \$0.01 per share or such greater amount as the institution's charter may require.

Do the warrants provide for net exercise?

Yes, the term sheet indicates that the warrants will allow for net exercise, which means that Treasury is not required to pay a cash exercise price when it exercises the warrants.

How are the terms of the Warrant Preferred different than the terms for the preferred shares purchased by Treasury at the initial closing?

The Warrant Preferred will have the same rights as the preferred purchased by Treasury at the initial closing, except that the dividend rate for the Warrant Preferred will be 9% and the Warrant Preferred can not be redeemed until the preferred shares purchased at the initial closing have been redeemed in full.

Can the warrants or the Warrant Preferred be transferred by Treasury?

Yes, the warrants and the Warrant Preferred are freely transferable with the exception that Treasury can't transfer the warrants or the Warrant Preferred if the transfer would require the qualifying financial institution to be subject to the periodic reporting requirements of the Securities Exchange Act. If the institution otherwise becomes subject to these reporting requirements, it must file a shelf registration statement covering the warrants and the Warrant Preferred as promptly as practicable and take all action necessary to cause the registration statement to be declared effective. See our comment above about the ambiguous treatment of SEC filers and the shelf regulation requirement. In addition, Treasury, and its transferees, will have piggyback registration rights.

Must all participating qualifying financial institutions issue warrants and Warrant Preferred to Treasury in connection with the program?

Treasury has discretion to exempt certain investments from the warrant requirements. Treasury indicated in the term sheet that it will use this discretion conservatively and that at this time the only class of issuer that will not be required to issue warrants to Treasury is certified Community Development Financial Institutions that sell preferred shares to Treasury having a value of less than \$50 million.

What is a Community Development Financial Institution?

A Community Development Financial Institution is a specialized financial institution that works in market niches that are underserved by traditional financial institutions. These institutions provide a unique range of financial products and services in economically distressed target markets, like mortgage financing for low-income and first-time homebuyers and not-for-profit developers, flexible underwriting and risk capital for needed community facilities and technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas.

Must a participating qualifying financial institution currently be a Community Development Financial Institution to qualify for the warrant exemption?

No, but to qualify, an institution must have completed application to be a Community Development Financial Institution at the time it files its application to participate in the capital purchase program and the application must be approved at the closing of Treasury's investment. We understand that this application process will be streamlined to 30 days. The Community Development Financial Institution application must be approved by January 15, 2009.

Should you have any questions regarding this alert please feel free to contact Bob F. Thompson or Scott Holley at (615) 742-6200.

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