



# Commercial Financial Services Brief: October 2008

October 31, 2008

## **TROUBLED ASSETS RELIEF PROGRAM (TARP) - CAPITAL PURCHASE PROGRAM**

### **Overview**

The Capital Purchase Program (CPP) is a voluntary program designed to encourage financial institutions to build capital with the goal of increasing financing. The Treasury will purchase up to \$250 billion of senior preferred shares of certain banks, savings associations and holding companies. The program is available to financial institutions of all sizes.

### **Requirements of the CPP Program**

- Standardized application to participate in the CPP
- The minimum subscription amount is 1% of risk-weighted assets. Maximum subscription is 3% of risk-weighted assets
- Senior preferred shares will qualify as Tier 1 capital and will rank senior to common stock
- Senior preferred shares pay a dividend of 5% per annum for first 5 years, 9% per annum after 5th year
- Treasury can transfer preferred shares to third parties at any time
- Purchase of preferred shares will be accompanied by warrants to purchase common stock up to 15% of the preferred share investment
- Participating institutions must adopt Treasury standards for executive compensation and corporate governance while Treasury holds the shares
- Purchases will be announced to the public within 48 hours after the purchase is made

### **Key Date**

An election to participate in the program will need to be made by subject financial institutions no later than November 14, 2008.

### **Next Steps**

Each financial institution should:

1. Understand the requirements of the program

2. Assess whether its will participate in the CPP. This will require a full understanding of the obligations of the institution if it chooses to participate in the program.
3. Consult with its primary regulators regarding participation in the program.
4. If it determines to participate in the program, submit an application to its primary regulator on or before November 14, 2008.

### **Issues to be Resolved**

The following issues require additional clarification:

- *Eligibility Determination.* Eligibility for participation will be determined by the Treasury Department in consultation with the appropriate regulators. There is not indication how the applications will be prioritized for participation in the program.
- *Public Registration.* The Public Term Sheet requires that the preferred securities purchased by the Treasury are to be registered. Additional clarification is required regarding the availability of the program to financial institutions that are not SEC-registered entities.
- *Sub - S Issues.* The required issuance of preferred shares potentially affects the status of Subchapter S corporations. It is anticipated that additional guidance will be issued by the Treasury department regarding the participation of Subchapter S financial institutions in the program.

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## **FDIC TEMPORARY LIQUIDITY GUARANTEE PROGRAM (TLGP)**

### **TLGP Overview**

The FDIC issued interim rules establishing the Temporary Liquidity Guarantee Program (TLGP). The TLGP consists of two components:

- A temporary guarantee of newly issued senior unsecured debt
- A temporary and unlimited guarantee of the coverage of funds in non-interest bearing transaction accounts at FDIC-insured institutions

FDIC insured banks, U.S. bank holding companies, including financial holding companies; and specified U.S. savings and loan holding companies are subject to the new rules. Under the TLGP, the FDIC, as of October 14, 2008, implemented both guaranties for all eligible entities, without cost to the entity, for the first 30 days of the program. After that time, fees will be assessed as follows:

- For all newly issued senior unsecured debt, an annualized fee equal to 75 basis points multiplied by the amount of debt issued under this program.
- For non-interest-bearing transaction deposit accounts, a 10 basis point surcharge would be applied to non-interest-bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of \$250,000. This surcharge will be added to the participating bank's existing risk-



based deposit insurance premium paid on those deposits.

The amount of debt covered under the program for any institution is limited to 125% of the institution's debt outstanding as of September 30, 2008, that is scheduled to mature before June 30, 2009.

### **Scope of Guaranties**

The guaranties will only apply to the following:

- Newly issued senior unsecured debt issued on or before June 30, 2009 (including promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt). Coverage will be provided for three years beyond June 30, 2009, even if the liability has not matured.
- Funds in non-interest-bearing transaction deposit accounts held by FDIC-insured banks until December 31, 2009.

### **Opt-Out Required**

All eligible entities will be covered under the TLGP without cost to the entity for the first 30 days of the program. On or before November 12, 2008, eligible entities must inform the FDIC if they will opt out of the debt guarantee program or the transaction account guarantee program, or both. Beginning on November 13, 2008, unless an eligible entity has chosen to opt out of a component of the TLGP, it will be assessed fees for continued coverage under that component. An eligible entity's decision to opt out of either component of the TLGP will be made available to the public on the FDIC website.

For further information, please review the following article here.

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## **DIRECTOR'S RESPONSIBILITY - BANK LIQUIDITY**

### **Overview**

FDIC risk management guidelines require that all banks have Board-approved written policies and procedures for the day-to-day management of liquidity. The strategy and policies must be communicated throughout the bank. The Board must receive regular reports regarding the liquidity of the bank and must ensure that liquidity risk is monitored and controlled. Boards are responsible for oversight of the following:

- Procedures and controls for managing and monitoring liquidity at all times
- Preparing contingency funding plans
- Review liquidity on a regular basis and monitor internal and external influences on liquidity
- Periodic review of liquidity policies and procedures



## **Board Policy Requirements**

The FDIC guidelines for Board policies and procedures regarding liquidity issues address, among other things, the following areas:

- Board and management oversight
- Policies and procedures
- Management information systems
- Internal controls
- Warning Indicators
- Contingency Liquidity Plan
- Funding Sources
- Portfolio Management

## **Reassess Your Policies in an Uncertain Environment**

In these uncertain times with liquidity issues at the forefront, it is to be expected that your liquidity policies and procedures will receive scrutiny. You should assess your policies and procedures for compliance with the liquidity guidelines.

If you have any questions, please contact a member of the GPM Economic Recovery Team listed on the right-hand side of the Web page.

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