

The Shifting Boundaries of the TARP Capital Purchase Program

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Capital Purchase Program

- Are we eligible?
- What would we be issuing?
- Should we participate?
- How do we apply?
- Any lead time issues?
- How does this affect executive comp?

Are We Eligible?

- Current Capital Purchase Program
 - Public companies
 - Exchange-listed (NYSE, AMEX, NASDAQ)
- Treasury intends to develop a separate term sheet and has extended the Nov. 14 application deadline indefinitely for:
 - Public, non-exchange listed companies (OTCBB, pink sheets)
 - Private companies
 - S corps

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Are We Eligible? (cont.)

- “Healthy”—yes; “Troubled”—no. But what does this mean?
- Probable factors:
 - Viability without TARP capital
 - Operating earnings—pre-tax, pre-provision
 - Other available sources of capital—type, amount and probability
 - Prospective acquirers of non-viable institutions can apply on behalf of the acquired institution—need a signed acquisition agreement

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Are We Eligible? (cont.)

- CAMELS ratings
- Current and projected ratios—FDIC has been requesting:
 - Tier 1, Total and Leverage capital
 - Classified assets/(Net Tier 1 + ALLL)
 - (NPLs + OREO)/(Net Tier 1 + ALLL)
 - C&D loans/Total risk-based capital
- CRE concentrations
- Use of proceeds

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What Would We Be Issuing?

Senior Preferred Stock

(Full term sheet is available at www.treas.gov)

(Terms are for public, exchange-listed companies—terms for others have not yet been announced)

- Amount: 1%-3% of risk-weighted assets
- Voting: generally non-voting; votes on matters adversely affecting the class
- Dividend--5% initial, 9% after 5 years
 - Right to elect 2 directors if dividends are not fully paid for 6 periods (need not be consecutive)—ends when dividends for all past periods have been paid

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Senior Preferred Stock (cont.)

- Redemption: Redeemable within 3 years with proceeds from Tier 1 capital offering(s) (other than trust preferred) of at least 25% of the Senior Preferred issue price
 - Redeemable after 3 years with any source of funds
 - Redemption is subject to prior regulatory approval
- Registration:
 - Shelf registration statement required for resale of the Senior Preferred, warrants and warrant shares. If not S-3 eligible, may defer registration until Treasury requests it.
 - Registration rights for Treasury and subsequent holder(s)

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Senior Preferred Stock (cont.)

- Dividend and repurchase restrictions: during the first 3 years, you can't:
 - Increase common dividends or
 - Repurchase equity or trust preferred securities (with limited exceptions)

unless:

 - You have prior Treasury approval or
 - The Senior Preferred has been redeemed or transferred.

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Warrants

- Amount: 15% of the Senior Preferred dollar amount
- Exercise Price: the 20-trading day trailing average market price of the common stock on the date Treasury accepts the application.
- Payment of Exercise Price: net exercise, with payment in cash only with consent of the issuer
- Voting: warrant shares are non-voting while held by Treasury
- Term: 10 years
- Accounting: equity (not liability) treatment.

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Warrants (cont.)

- Registration:
 - Must include warrants and warrant shares in shelf registration and apply to list warrant shares on a national exchange
 - Registration rights for Treasury and subsequent holder(s)
- Reduction: if the Company raises Tier 1 capital (not TPS) equal to at least 100% of the issue price of the Senior Preferred by Dec. 31, 2009, the number of warrants will be reduced by 50%.
 - Not conditioned upon using offering proceeds to redeem Senior Preferred.
 - Calculated based on total investment, but applies only to warrants then held by Treasury

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Warrants (cont.)

- Exercise/Transfer Limitations: Treasury can transfer or exercise only 50% of the warrants before the earlier of:
 - Dec. 31, 2009 or
 - Company's receipt of 100% of the issue price of the Senior Preferred from Tier 1 capital offering(s) (excluding TPS)
- Anti-Dilution: Adjustment required for:
 - Issuance of new shares during the first 3 years for less than 90% of market price on the last trading day before the warrant was issued or
 - Dividend increases above last dividend declared before the warrant was issued.

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Warrants (cont.)

- Repurchase Right:
 - May repurchase all or some of the warrants or warrant shares held by Treasury after the Senior Preferred has been redeemed in full or transferred to a third party.
 - Allows the Company to terminate Treasury's investment (and related executive comp limitations).
- Substitution: Treasury can exchange warrants for "an economic interest...classified as permanent equity under GAAP" with equivalent fair market value if the issuer:
 - Is no longer exchange listed or
 - Can't obtain shareholder approval to issue warrant shares (if required) within 18 months after issuance

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Should We Participate?

- Considerations
 - Take a hard look at your loan portfolio under a “worst case” recession scenario—will you need capital?
 - Dilution and earnings impact should not be primary concerns.
 - Generally, the lower your P/E ratio, the more attractive TARP capital is.
 - Common dividend increases and equity/trust preferred repurchases would be restricted...but would they be the best use of capital?
 - Any restrictions on the bank’s ability to pay dividends to the holding company?

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Should We Participate? (cont.)

- How do you plan to use the proceeds?
 - Lend
 - Acquire other banks
 - Organic growth
 - Boost capital reserves
 - Pay dividends
 - Compensation
 - Be aware of PR and political issues—the world is watching!

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Should We Participate? (cont.)

- Perception factors
 - “Bailout” perception by customers/community
 - Treasury’s implied “stamp of approval”...or the opposite
- Competitive effects—don’t get left behind
- Treasury will have the right to examine books and records—
but regulators have that anyway
- Uncle Sam is now a significant investor...but increased
industry regulation will come, regardless of whether you
participate

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Should We Participate? (cont.)

- Compare to other capital alternatives—current market
conditions alter traditional analysis
- Can you live with the executive comp limitations? Will your
executives agree to them?
- What’s your exit strategy?
 - New Tier 1 capital by the end of 2009 to reduce warrants
 - 3-year call date
 - 5-year dividend increase

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Should We Participate? (cont.)

- Who's in so far?
 - As of Nov. 4, 2008, 43 institutions had announced Treasury approval for participation
 - Approximately \$170 billion allocated among them
 - Range of investments:
 - \$1 million to \$25 billion
 - "Big 9" range: \$2 billion to \$25 billion—total of \$125 billion
 - Remainder—roughly 40% approved for > \$1 billion

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How Do We Apply?

- Application and instructions are available on Fed, FDIC, OCC and OTS websites (joint press release issued Oct. 20, 2008) and at www.bankpogo.com.
- Application and Nov. 14, 2008 deadline apply only to public, exchange-listed issuers
- Treasury contemplates a different application and later deadline for other issuers
- In the meantime, only applications from public, exchange-listed issuers are being forwarded to Treasury, although regulators continue to review all submissions

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How Do We Apply? (cont.)

- Review Securities Purchase Agreement and related documents (posted on Treasury’s website and at www.bankpogo.com) and confirm review in application
- Determine ability to comply with reps, warranties, covenants and closing conditions—especially registration and authorization of shares
- “Robustly explain” any limitations in ability to execute the required documents or meet closing conditions
- Also describe in detail any pending capital-raising or M&A transactions—may request confidential treatment

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How Do We Apply? (cont.)

- Submit applications to:
 - *Federal Reserve*: Nicky Hennings (nicky.hennings@atl.frb.org), with a copy to Kate Gaboardi (kate.gaboardi@atl.frb.org).
 - *FDIC*: Tony Womack (awomack@fdic.gov).
 - State banks should copy the Georgia Department of Banking and Finance.
 - *OCC*: contact Fred Finke (fred.finke@occ.treas.gov) for more information and send applications to HQ.Licensing@occ.treas.gov or OCC Director of Licensing, 250 E St. SW, Mail Stop 7-13, Washington DC, 20219-0001.
 - *OTS*: Yashica Pope (yashica.pope@ots.treas.gov) via secure email, with copies to the thrift’s Review Examiner or AD.

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How Do We Apply? (cont.)

- Post-submission:
 - Regulators review application and make recommendation to Treasury
 - Treasury issues preliminary approval “promptly”—roughly 5-7 business days after application
 - No publication of rejection or withdrawal
 - Within 48 hours after final approval, Treasury will publicly announce participation
 - Must submit final documentation and fulfill any outstanding requirements within 30 days after approval

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Lead Time Issues

- Shareholder Approval:
 - Articles of incorporation may need to be amended to provide:
 - Authority to issue preferred stock
 - Sufficient number of authorized shares of common stock to cover warrants upon exercise
 - Determine whether warrant exercise would trigger stock exchange requirements for shareholder approval
 - Bylaws may need SH approval to expand board to accommodate 2 potential additional directors

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Lead Time Issues (cont.)

- If shareholder approval is needed:
 - Public companies must file preliminary proxy materials with SEC for potential review
 - Charter must provide for issuance of Senior Preferred prior to closing
 - Warrant-related approvals can wait, but exercise price goes down by 15% every 6 months until shareholder approval is obtained, with substitution of other instrument(s) after 18 months
- Must review executive compensation arrangements and take actions necessary to comply with applicable restrictions

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Executive Comp Restrictions

- Restrictions apply to the “Top 5”:
 - Principal executive officer
 - Principal financial officer
 - 3 other most highly compensated executive officers
- “Clawback” provision requires recovery of incentive comp paid based on materially inaccurate statements of earnings or other criteria
- Cannot deduct more than \$500,000 of total annual executive comp for each of the Top 5
- Within 90 days after closing, must certify that incentive comp arrangements do not encourage unnecessary risk-taking

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Executive Comp Restrictions (cont.)

- “Golden Parachute” prohibition—applies to Top 5
 - Unlike 280G, change in control is not required—triggered instead by:
 - involuntary termination (including after bankruptcy/receivership) by employer when employee is willing/able to continue;
 - employer’s failure to renew employment agreement when employee is willing/able to continue on similar terms;
 - voluntary termination following a material negative change in employment relationship; or
 - voluntary termination when it’s clear that involuntary termination would soon follow
 - Present value of severance payments must be less than 3 times average total compensation for the prior 5 years

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Long-term Questions

- Hoard or lend?
 - Treasury wants banks to lend proceeds, but there’s no requirement to do so
 - Tough times ahead justify significant capital reserves; asset quality is still an issue
- Politics--foreclosure mitigation, loan modifications
- How will TARP affect private equity investment activity?
- Competitive landscape—will this prolong life for irrational competitors?

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Long-term Questions (cont.)

- Funding for increased M&A?
 - Cheap capital for potential acquirors...
 - But M&A volume may not increase if banks that might otherwise sell may get new leases on life
- How will the capital ultimately be allocated?
 - Liquidity vs. breadth of opportunity for participation
 - Investments outside the banking industry
- Treasury has a broad array of powers—how aggressively will it use them?

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