TARP INTERIM RULE

by Steve Brown

You may not have known it, but Campbell's brands include not only Campbell's Soup, but also Pace, Prego, Swanson, StockPot, V8 and Pepperidge Farm. As we continue to work our way through the week with a "soup" theme, we thought you might find that interesting. Ok, that is a reach, but since it is obvious we are running out of soup and soup-like ideas, let's get right to the Troubled Assets Relief Program ("TARP") and more specifically the Capital Purchase Program ("CPP") within TARP.

CPP provides $250B in capital to US financial institutions ("banks") in the form of preferred stock. This voluntary program is designed to help banks build capital, with an overarching goal of increasing financing to businesses and consumers. The program was designed specifically for healthy institutions, to allow them to attract additional private capital and encourage increased lending/acquisitions.

Banks sell equity interests to the UST in amounts equal to 1% minimum to 3% maximum of risk-weighted assets. Capital injections go directly into the bank holding company and are Tier 1 capital. Calculations show that if every bank in the country took the 3% max limit, the UST would still be able to fund each bank, so the program is not first come first served.

Banks apply for the capital injection through their primary federal regulator using a single application form (albeit designed for publicly-held financial institutions). While banks do not need to have required internal authorizations by the submission of the application, once the bank is notified of preliminary acceptance, it has only 30 days to submit final documentation and fulfill any outstanding requirements. Treasury has indicated they will publicly announce all approvals, but it will not report applications that were withdrawn or denied. Already, half of the $250B set aside for this purpose has been spent on the 9 largest banks in the US and more is being allocated each day.

Program costs and detailed structure is as follows: Counts as Tier 1 capital; term is perpetual; pays dividends at 5% for first 5Ys and 9% thereafter; dividends are payable quarterly in arrears on Feb 15, May 15, Aug 15 and Nov 15; may be called after 3Ys by the bank (at par, plus any accrued and unpaid dividends); is nonvoting; provides the right to elect 2 directors if dividends are not paid in full for 6 periods (does not have to be consecutive); banks cannot increase dividends, repurchase shares (or TRUPs) or do any M&A without prior approval from regulators; executive compensation is limited to UST standards; includes warrants with a 10Y term equal to 15% of preferred.

Considerations are numerous, but here are some that many banks have asked us about: Issuance of the preferred does not dilute existing shareholders (but the exercise of warrants will be a small dilution); CPP will likely increase consolidation in the industry (program gives capital to healthy banks to help them swallow weaker banks); the capital will not be made available to weaker banks; UST is aware that private banks cannot participate under the current structure (they are working on those issues); UST is not likely to extend the timeline or change the structure for publicly traded banks (but we believe they will extend it for Sub S and private banks); all banks should still submit their application by Nov 14 (but be sure to describe any structural conditions that may not comply with existing guidelines); banks may have to amend articles of incorporation to authorize additional shares (so get started); the criteria for evaluating applications is not defined (but appears to be loosely based on CAMELS ratings).

Our thoughts: for most community banks, this is inexpensive capital and many banks will benefit; this capital can be used to offset future loan losses, absorb the impact of current loan losses and other than temporary impairments (FNMA/FHLMC preferred stock); will make depositors feel more secure (provides opportunity to capture new customers) and is covered with balance sheet growth of only about 5 to 1($5 of balance sheet growth for each $1 of CPP), well below the implied 8% Tier I capital ratio of 12.5 to 1 and provide more flexibility.

CPP is still evolving for private and Sub S banks, so we will update as further information is disseminated by the UST. In the meantime, we welcome your thoughts and questions, so please reply to this email if you feel so inclined.

Tomorrow we will wrap up our week of this alphabet soup by answering as many questions as we can on all of these programs and providing further insight as to how we see things shaking out when it is all said and done.

BANK NEWS

Prime

Most major banks have reset their Prime or reference rate to 4% effective today. While several are holding out, such as Keycorp, Zions, First Horizon, BB&T and HSBC, we expect them to do so today.

Prices Drop

August marked the fastest home price drops in 20 U.S. cities. According to the S&P/Case-Shiller Home price index, prices fell 16.6% in August compared to last year and 1% for month to month.

Jobs Pressure

Right now, there are an estimated 2.9 unemployed workers per available job in the US.