

TARPOONED: The Recapitalization of the US Financial Industry

October 16, 2008

After a week that saw U.S. and international financial markets submerged in panic and major stock indices worldwide sink to bottoms not seen in years, on October 14, the U.S. Treasury, Federal Reserve and FDIC announced the following watershed measures aimed at rescuing the flailing U.S. markets:¹

Capital Purchase Program. Treasury announced² it will use \$250 billion of its \$700-billion treasure chest under The Emergency Economic Stabilization Act of 2008 ("EESA") to purchase \$125 billion of senior preferred shares in nine major financial institutions, with the remaining \$125 billion available for equity injections into qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that elect to participate before 5:00 pm (EDT) on November 14, 2008.

These financial institutions and the amount of the equity injection each of them will receive are:

– JPMorgan Chase & Co.	\$25 billion
– Citigroup Inc.	\$25 billion
– Wells Fargo & Co.	\$25 billion
– Bank of America Corp.	\$25 billion
– Goldman Sachs Group Inc.	\$10 billion
– Morgan Stanley	\$10 billion
– Bank of New York Mellon	\$ 3 billion
– State Street Corp.	\$ 2 billion

FDIC Temporary Liquidity Guarantee Program. The FDIC announced³ it will temporarily guarantee, for a fee, all newly issued senior unsecured debt of banks, thrifts and

¹ See "Joint Statement by Treasury, Federal Reserve and FDIC" – October 14, 2008. <http://www.ustreas.gov/press/releases/hp1207.htm>.

² See "Treasury Announces TARP Capital Purchase Program Description." – October 14, 2008. <http://www.ustreas.gov/press/releases/hp1207.htm>.

³ See "FDIC Announces Plan to Free Up Bank Liquidity: Creates New Program to Guarantee Bank Debt and Fully Insure Non-Interest Bearing Deposit Transaction Accounts." – October 14, 2008. <http://www.fdic.gov/news/news/press/2008/pr08100.html>.

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certain holding companies, and provide full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount.

Commercial Paper Funding Facility. The Federal Reserve released⁴ additional details about its Commercial Paper Funding Facility,⁵ including that it would begin funding purchases of commercial paper on October 27. This facility complements the Federal Reserve's existing credit facilities to help provide a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle that will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers.

In a related development, on October 14, the Treasury announced⁶ the executive compensation rules under EESA that apply to the Capital Purchase Program and other troubled asset purchase programs being developed under EESA.

This memorandum will focus on two matters of interest: First, we will describe the nuts and bolts of the Capital Purchase Program which the Treasury will use to implement the historic recapitalization of the U.S. banking and financial industries. Second, we will explore the legislative developments related to the passage of EESA and the Treasury's evolving priorities with respect to purchasing troubled assets leading to its current focus on injecting equity capital into healthy as well as distressed financial institutions.

The Capital Purchase Program

Statutory Basis

Section 101 of EESA establishes the now well-known Troubled Asset Relief Program ("TARP") and authorizes the Treasury to purchase, and to make and fund commitments to purchase, troubled assets from financial institutions⁷ up to an amount not exceeding

⁴ See *Federal Reserve Press Release*, October 14, 2008: <http://www.federalreserve.gov/newsevents/press/monetary/20081014b.htm>.

⁵ The Federal Reserve originally announced the Commercial Paper Funding Facility on October 7, 2008. See *Federal Reserve Press Release*, October 7, 2008: <http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm>.

⁶ See "Treasury Announces Executive Compensation Rules Under the Emergency Economic Stabilization Act." – October 14, 2008. <http://www.ustreas.gov/press/releases/hp1208.htm>.

⁷ The term "financial institution" is defined in Section 3(5) of EESA to mean "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any state, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government."

\$700 billion outstanding at any one time, as adjusted for the operation of the companion guarantee program.

The term "troubled assets" is defined in Section 3(9) of EESA to mean:

(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and

(B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.

The definition, especially clause (B) with its reference to "any other financial instrument," has been written to ensure that TARP not only covers a broad range of assets, such as credit default swaps, student loans, auto loans and other leveraged loans provided by financial institutions, but a potentially somewhat broader range of instruments, as long as the Secretary determines that purchases under that clause are necessary to promote financial stability.

Salient Terms

The Treasury has announced that it will make its equity injections into financial institutions by purchasing their senior preferred shares on "attractive terms." In conjunction with such purchase, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15 percent of the senior preferred investment and with an exercise price equal to the market price of the participating institution's common stock at the time of issuance, calculated on a 20-trading day trailing average.⁸

The Treasury has released⁹ a detailed term sheet (attached to this memorandum as Annex A) that contains the salient terms of the senior preferred shares and the warrants of the participating financial institutions, some of which are summarized below:

⁸ The Treasury is required to obtain these warrants pursuant to Section 113(d) of EESA that requires the Secretary to receive a warrant exercisable for non-voting preferred stock or common stock (or, sometimes, a senior debt instrument) from each financial institution whose troubled assets are purchased under TARP.

⁹ See footnote number 2 above.

Subscription Amount. Minimum: one percent of risk-weighted assets. Maximum: lesser of \$25 billion or three percent of risk-weighted assets.

Status and Rank. The senior preferred shares will qualify as Tier 1 capital and will rank senior to common stock and *pari passu* with existing preferred shares, other than preferred shares which by their terms rank junior to any other existing preferred shares.

Dividend. The senior preferred shares will have a cumulative dividend rate of five percent per annum for the first five years and will reset to a rate of nine percent per annum after year five.

Voting. The senior preferred shares will be non-voting, other than class voting rights on matters that could adversely affect the shares.

Redemption. The senior preferred shares will be callable at par after three years. Prior to the end of three years, the senior preferred may be redeemed with the proceeds from a qualifying equity offering of any Tier 1 perpetual preferred or common stock. The Treasury may also transfer the senior preferred shares to a third party at any time.

Executive Compensation and Corporate Governance Standards

As required by Section 111 of EESA, any financial institution participating in the Capital Purchase Program will be required to adopt certain executive compensation and corporate governance standards for the period during which the Treasury holds equity, with respect to its chief executive officer, chief financial officer, plus the next three most highly compensated executive officers. The Treasury has issued interim final rules for these executive compensation standards. Such standards include the following:

- Ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution.
- Requiring clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate.
- Prohibition on the financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision.
- Agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

From Purchasing Toxic Assets to Injecting Equity Capital

The credit troubles that originated in the subprime mortgage lending industry metastasized with astonishing speed and ferocity into a full-blown crisis in the US and international financial markets. Many storied financial institutions, such as AIG, Lehman Brothers, Fannie Mae, Freddie Mac, Washington Mutual, Wachovia, have crumbled and in some cases have had to be rescued through ad hoc measures. It became clear that a massive, comprehensive and coordinated government rescue effort was needed urgently. On September 19, Treasury Secretary Henry Paulson unveiled his proposal (the "Paulson Proposal") to use \$700 billion in taxpayer money to purchase toxic mortgage-related assets that were weighing heavily on the balance sheets of financial institutions. The rationale, as vigorously advocated by Treasury and the Federal Reserve, was that once freed from the enormous burden of these illiquid assets, financial institutions would be able to gradually resume the flow of credit and breathe life back into the frozen financial markets.

The Passage of EESA

On October 3, the U.S. House of Representatives voted 263-171 to pass the EESA bill. Within hours, President Bush signed the bill and EESA was part of the law of the land. The passage of EESA was preceded by a tumultuous two weeks during which the minimalist three-page Paulson Proposal gathered controversy and heft to morph first into the 110-page bill that was spectacularly voted down by the U.S. House of Representatives on September 29 by a margin of 228-205. The market's reaction was swift and stark with the Dow Jones Industrial Average plunging 777 points on that day, obliterating approximately \$1.2 trillion of shareholder value. In a calculated political response, on October 1, the Senate voted 74-25 to approve an "amendment" to the EESA bill that spliced onto a largely unchanged House version of the EESA bill a raft of stalled tax bills, namely the Energy Improvement and Extension Act of 2008 and Tax Extenders and Alternative Minimum Tax Relief Act of 2008. The Senate's move added up to \$150 billion in additional costs and several hundred pages to make the EESA bill about 450 pages long. The only substantive change made to the EESA bill that failed in the House was to add a provision that increased until December 31, 2009 the amount of deposit insurance provided by the FDIC from \$100,000 to \$250,000. This amended version of the EESA bill was sent back to the House, which approved it 263-171 on October 3.

The Troubled Asset Relief Program

The keystone of the bailout legislation has from the start been the Troubled Asset Relief Program or "TARP." Less than a week after the introduction of the original Paulson Proposal, on September 23, both Secretary Paulson and Chairman Bernanke testified before the Senate Banking Committee with respect to the continuing financial crisis and the rescue measures proposed by the Treasury.

- In his testimony, Secretary Paulson stated:¹⁰ *"We must now take further, decisive action to fundamentally and comprehensively address the root cause of this turmoil. And that root cause is the housing correction which has resulted in illiquid mortgage-related assets that are choking off the flow of credit which is so vitally important to our economy... We have proposed a program to remove troubled assets from the system. This troubled asset relief program has to be properly designed for immediate implementation and be sufficiently large to have maximum impact and restore market confidence... **This troubled asset purchase program on its own is the single most effective thing we can do to help homeowners, the American people and stimulate our economy.**"* (emphasis added).
- In his testimony, Chairman Bernanke stated:¹¹ *"Action by the Congress is urgently required to stabilize the situation and avert what otherwise could be very serious consequences for our financial markets and for our economy. **In this regard, the Federal Reserve supports the Treasury's proposal to buy illiquid assets from financial institutions. Purchasing impaired assets will create liquidity and promote price discovery in the markets for these assets, while reducing investor uncertainty about the current value and prospects of financial institutions.** More generally, removing these assets from institutions' balance sheets will help to restore confidence in our financial markets and enable banks and other institutions to raise capital and to expand credit to support economic growth."* (emphasis added).

Unmistakably, TARP was touted by the Treasury and the Federal Reserve as a critical rescue measure that would use up to \$700 billion of taxpayer money to soak up toxic mortgage-related assets from a wide variety of financial institutions in order to boost the liquidity and confidence of the financial markets.

The Dow Jones Industrial Average greeted the passage of EESA by dropping a further 157 points beyond the precipitous drops of the preceding couple of days. The fierce criticism of EESA, particularly of TARP's apparent focus on purchasing impaired mortgage related assets, from a wide range of commentators likely contributed to the market's underwhelming reception to EESA. Many of these commentators argued fervently that the right way to do the bailout would be for the Treasury to recapitalize the affected financial

¹⁰ See "Testimony by Secretary Henry M. Paulson, Jr. before the Senate Banking Committee on Turmoil in US Credit Markets: Recent Actions regarding Government Sponsored Entities, Investment Banks and other Financial Institutions" – <http://www.treas.gov/press/releases/hp1153.htm>.

¹¹ See "Testimony of Chairman Ben S. Bernanke, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 23, 2008" – <http://www.federalreserve.gov/newsevents/testimony/bernanke20080923a1.htm>.

institutions by purchasing their preferred stock, thereby injecting fresh money (and increased lending capacity) into these institutions.¹²

Treasury's Change of Focus

On October 8, during a press conference addressing the continuing efforts of the Treasury to counter the financial crisis, Secretary Paulson released a public statement¹³ that included the following passages:

“We went to Congress and asked for broad new authorities to address the current troubles affecting our financial markets, including the root cause of the financial system freeze – the illiquid mortgage assets weighing on bank balance sheets. And Congress met the very difficult challenge of providing these authorities by passing the EESA.

*Specifically, the EESA empowers Treasury to use up to \$700 billion to **inject capital into financial institutions**, to purchase or insure mortgage assets, and to purchase any other troubled assets that the Treasury and the Federal Reserve deem necessary to promote financial market stability.”* (emphasis added)

It is notable that Secretary Paulson identified “*injecting capital into financial institutions*” as the first of several important powers authorized by EESA. A close examination of the definition of “troubled assets” does not reveal the word “equity.” So, was Secretary Paulson’s statement on October 8th an unintended slip? Not likely. On Friday, October 10, after the completion of the much-publicized meeting of the G-7 finance ministers in Washington DC, Secretary Paulson released another public statement¹⁴ in which he stated:

*“I briefed my colleagues on the work we are pursuing to implement swiftly and thoughtfully the new financial rescue package. We are developing strategies to use the authority to purchase and insure mortgage assets and to purchase equity in financial institutions, as deemed necessary to promote financial market stability. **As we develop plans to pur-***

¹² See, for example, the comment piece “Recapitalise the banking system” by George Soros published in the *Financial Times* on October 1 2008 – <http://www.ft.com/cms/s/0/d68e10cc-8f45-11dd-946c-0000779fd18c.html>.

¹³ See “Statement by Secretary Henry M. Paulson, Jr. on Financial Markets Update” – <http://www.ustreas.gov/press/releases/hp1189.htm>.

¹⁴ See “Statement by Secretary Henry M. Paulson, Jr. Following Meeting of the G-7 Finance Ministers and Central Bank Governors” – <http://www.ustreas.gov/press/releases/hp1194.htm>.

chase equity, as in the approach we are taking to broad mortgage asset purchases, we are working to develop a standardized program that is open to a broad array of financial institutions. Such a program would be designed to encourage the raising of new private capital to complement public capital. Consistent with the legislation, any equity the government purchases through a broadly available equity program would be on a non-voting basis, except with respect to the market standard terms to protect our rights as investors.” (emphasis added)

There you have it. Secretary Paulson did indeed unambiguously announce that the Treasury was working to develop a “standardized program” to purchase equity in financial institutions that would accommodate some sort of private participation. The calls of commentators pushing for exactly this sort of focus on recapitalization seems to have been heard and heeded to by the Treasury.

On October 13, Interim Assistant Secretary for Financial Stability Neel Kashkari spoke before the Institute of International Bankers to provide an update on the Treasury's implementation of TARP. During his talk he further emphasized the importance that equity contributions had taken on:¹⁵

“The law gives the Treasury Secretary broad and flexible authority to purchase and insure mortgage assets, and to purchase any other financial instrument that the Secretary, in consultation with the Federal Reserve Chairman, deems necessary to stabilize our financial markets -- including equity securities. Treasury worked hard with Congress to build in this flexibility because the one constant throughout the credit crisis has been its unpredictability.

*We are designing a standardized program to purchase equity in a broad array of financial institutions. As with the other programs, the equity purchase program will be voluntary and designed with attractive terms to encourage participation from healthy institutions. It will also encourage firms to raise new private capital to complement public capital.” (emphasis added).*¹⁶

¹⁵ See "Interim Assistant Secretary for Financial Stability Neel Kashkari Remarks before the Institute of International Bankers" – October 13, 2008. – <http://www.treas.gov/press/releases/hp1199.htm>.

¹⁶ These direct purchases of equity should not be confused with the provisions of Section 113(d) of EESA that require the Secretary to receive a warrant exercisable for non-voting preferred stock or common stock (and, sometimes, a senior debt instrument) from each financial institution whose troubled assets are purchased under TARP.

The Fascinating Behind the Scenes Legislative Fix

As described above, the definition of "troubled assets" in Section 3(9) of EESA has two prongs. Clause (A) thereof permits the purchase of "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages." Clause (B) thereof is much broader; it permits the purchase of "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability." This second prong on its face gives the Secretary extremely wide latitude as long as the necessary goal of promoting financial market stability is satisfied. However, in light of the fact that EESA and TARP were originally conceived and subsequently advocated for by the Treasury as a rescue plan to purchase and soak up distressed assets (as opposed to injecting equity capital), the view seems to have arisen that it would be wise to flesh out the general authorization contained in clause (B) in the definition of "troubled assets." As first reported by Professor Nouriel Roubini of NYU's Stern Business School,¹⁷ the mechanism employed to accomplish this result was to have Representative Jim Moran and Representative Barney Frank use the October 3rd House of Representatives floor debate right before the final vote. See the following exchange between Representative Frank and Representative Moran:¹⁸

Mr. FRANK of Massachusetts. I yield 1 1/2 minutes to the gentleman from Virginia (Mr. Moran) for the purpose of a colloquy.

Mr. MORAN of Virginia. Thank you, Madam Speaker. I won't take that much time. I do want to thank the chairman for his masterful leadership on this bill, and I do want to clarify that the intent of this legislation is to authorize the Treasury Department to strengthen credit markets by infusing capital into weak institutions in two ways: By buying their stock, debt, or other capital instruments; and, two, by purchasing bad assets from the institutions, in coordination with existing regulatory agencies and their responsibilities under this legislation, as well as under already existing authorization for prompt, corrective action and least-cost resolution.

¹⁷ See "How authorization to recapitalize banks via public capital injections ("partial nationalization") was introduced - indirectly through the back door - into the TARP legislation" by Nouriel Roubini -- <http://www.rgemonitor.com/roubini-monitor/253956>.

¹⁸ See US Congress. House. Emergency Economic Stabilization Act of 2008. 110th Cong., 2nd sess., H.R. 1424. Congressional Record. 154, no. 161, daily ed. (3 October 2008): H10763. -- <http://frwebgate2.access.gpo.gov/cgi-bin/waisgate.cgi?WAISdocID=880698252764+1+0+0&WAIAction=retrieve>.

Mr. FRANK of Massachusetts. Will the gentleman yield?

Mr. MORAN of Virginia. I'd be happy to yield.

Mr. FRANK of Massachusetts. I can affirm that. As the gentleman knows, the Treasury Department is in agreement with this, and we should be clear, this is one of the things that this House and the Senate added to the bill, the authority to buy equity. It is not simply buying up the assets, it is to buy equity, and to buy equity in a way that the Federal Government will be able to benefit if there is an appreciation. I thank the gentleman for this important clarification. He is absolutely right.

*In implementing the powers provided for in the Emergency Economic Stabilization Act of 2008, it is the intent of Congress that Treasury should use Troubled Asset Relief Program (TARP) resources **to fund capital infusion** and asset purchase approaches alone or in conjunction with each other to enable financial institutions to begin providing credit again, and to do so in ways that minimize the burden on taxpayers and have maximum economic recovery impact. **Where the legislation speaks of "assets", that term is intended to include capital instruments of an institution such as common and preferred stock, subordinated and senior debt, and equity rights.** Also, it is the intent of this legislation that TARP resources should be used in coordination with regulatory agencies and their responsibilities under prompt corrective-action and least-cost resolution statutes.*

Mr. MORAN of Virginia. Nice going, Chairman. Thank you. (emphasis added)

The above critical exchange between Representative Barney Frank and Representative Jim Moran on the floor of the House of Representatives and now part of the Congressional record of the passage of the EESA bill bolsters the conclusion that Congress intended this broad interpretation of the words "any other financial instrument" in the definition of "troubled assets." It is indeed fascinating that a bill that started out as an unprecedented mechanism to purchase distressed mortgage assets has now become the law that authorizes historic and once inconceivable recapitalization of the U.S. financial industry by the US government.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Annex A

TARP Capital Purchase Program

Senior Preferred Stock and Warrants

Summary of Senior Preferred Terms

- Issuer:** Qualifying Financial Institution (“QFI”) means (i) any U.S. bank or U.S. savings association not controlled by a Bank Holding Company (“BHC”) or Savings and Loan Holding Company (“SLHC”); (ii) any U.S. BHC, or any U.S. SLHC which engages only in activities permitted for financial holdings companies under Section 4(k) of the Bank Holding Company Act, and any U.S. bank or U.S. savings association controlled by such a qualifying U.S. BHC or U.S. SLHC; and (iii) any U.S. BHC or U.S. SLHC whose U.S. depository institution subsidiaries are the subject of an application under Section 4(c)(8) of the Bank Holding Company Act; except that QFI shall not mean any BHC, SLHC, bank or savings association that is controlled by a foreign bank or company. For purposes of this program, “U.S. bank”, “U.S. savings association”, “U.S. BHC” and “U.S. SLHC” means a bank, savings association, BHC or SLHC organized under the laws of the United States or any State of the United States, the District of Columbia, any territory or possession of the United States, Puerto Rico, Northern Mariana Islands, Guam, American Samoa, or the Virgin Islands. **The United States Department of the Treasury will determine eligibility and allocation for QFIs after consultation with the appropriate Federal banking agency.**
- Initial Holder:** United States Department of the Treasury (the “UST”).
- Size:** QFIs may sell preferred to the UST subject to the limits and terms described below.
- Each QFI may issue an amount of Senior Preferred equal to not less than 1% of its risk-weighted assets and not more than the lesser of (i) \$25 billion and (ii) 3% of its risk-weighted assets.
- Security:** Senior Preferred, liquidation preference \$1,000 per share. (Depending upon the QFI’s available authorized preferred shares, the UST may agree to purchase Senior Preferred with a higher liquidation preference per share, in which case the UST may require the QFI to appoint a depository to hold the Senior Preferred and issue depository receipts.)
- Ranking:** Senior to common stock and pari passu with existing preferred shares other than preferred shares which by their terms rank junior to any existing preferred shares.

**Regulatory
Capital
Status:**

Tier 1.

Term:

Perpetual life.

Dividend:

The Senior Preferred will pay cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per annum. For Senior Preferred issued by banks which are not subsidiaries of holding companies, the Senior Preferred will pay non-cumulative dividends at a rate of 5% per annum until the fifth anniversary of the date of this investment and thereafter at a rate of 9% per annum. Dividends will be payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.

Redemption:

Senior Preferred may not be redeemed for a period of three years from the date of this investment, except with the proceeds from a Qualified Equity Offering (as defined below) which results in aggregate gross proceeds to the QFI of not less than 25% of the issue price of the Senior Preferred. After the third anniversary of the date of this investment, the Senior Preferred may be redeemed, in whole or in part, at any time and from time to time, at the option of the QFI. All redemptions of the Senior Preferred shall be at 100% of its issue price, plus (i) in the case of cumulative Senior Preferred, any accrued and unpaid dividends and (ii) in the case of non-cumulative Senior Preferred, accrued and unpaid dividends for the then current dividend period (regardless of whether any dividends are actually declared for such dividend period), and shall be subject to the approval of the QFI's primary federal bank regulator.

“Qualified Equity Offering” shall mean the sale by the QFI after the date of this investment of Tier 1 qualifying perpetual preferred stock or common stock for cash.

Following the redemption in whole of the Senior Preferred held by the UST, the QFI shall have the right to repurchase any other equity security of the QFI held by the UST at fair market value.

**Restrictions
on Dividends:**

For as long as any Senior Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Senior Preferred), nor may the QFI repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Senior Preferred or common shares, unless (i) in the case of cumulative Senior Preferred all accrued and unpaid dividends for all past dividend periods on the Senior Preferred are fully paid or (ii) in the case of non-cumulative Senior Preferred the full dividend for the latest completed dividend period has been declared and paid in full.

Common dividends: The UST's consent shall be required for any increase in common dividends per share until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred is redeemed in whole or the UST has transferred all of the Senior Preferred to third parties.

Repurchases: The UST's consent shall be required for any share repurchases (other than (i) repurchases of the Senior Preferred and (ii) repurchases of junior preferred shares or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice) until the third anniversary of the date of this investment unless prior to such third anniversary the Senior Preferred is redeemed in whole or the UST has transferred all of the Senior Preferred to third parties. In addition, there shall be no share repurchases of junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares if prohibited as described above under "Restrictions on Dividends".

Voting rights: The Senior Preferred shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Senior Preferred, (ii) any amendment to the rights of Senior Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Senior Preferred.

If dividends on the Senior Preferred are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

Transferability: The Senior Preferred will not be subject to any contractual restrictions on transfer. The QFI will file a shelf registration statement covering the Senior Preferred as promptly as practicable after the date of this investment and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. The QFI will also grant to the UST piggyback registration rights for the Senior Preferred and will take such other steps as may be reasonably requested to facilitate the transfer of the Senior Preferred including, if requested by the UST, using reasonable efforts to list the Senior Preferred on a national securities exchange. If requested by the UST, the QFI will appoint a depositary to hold the Senior Preferred and issue depositary receipts.

Executive Compensation: As a condition to the closing of this investment, the QFI and its senior executive officers covered by the EESA shall modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to be in compliance with, and following the closing and for so long as UST holds any equity or debt securities of the QFI, the QFI shall agree to be bound by, the executive compensation and corporate governance requirements of Section 111 of the EESA and any guidance or regulations issued by the Secretary of the Treasury on or prior to the date of this investment to carry out the provisions of such subsection. As an additional condition to closing, the QFI and its senior executive officers covered by the EESA shall grant to the UST a waiver releasing the UST from any claims that the QFI and such senior executive officers may otherwise have as a result of the issuance of any regulations which modify the terms of benefits plans, arrangements and agreements to eliminate any provisions that would not be in compliance with the executive compensation and corporate governance requirements of Section 111 of the EESA and any guidance or regulations issued by the Secretary of the Treasury on or prior to the date of this investment to carry out the provisions of such subsection.

Summary of Warrant Terms

- Warrant:** The UST will receive warrants to purchase a number of shares of common stock of the QFI having an aggregate market price equal to 15% of the Senior Preferred amount on the date of investment, subject to reduction as set forth below under “Reduction”. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, shall be the market price for the common stock on the date of the Senior Preferred investment (calculated on a 20-trading day trailing average), subject to customary anti-dilution adjustments. The exercise price shall be reduced by 15% of the original exercise price on each six-month anniversary of the issue date of the warrants if the consent of the QFI stockholders described below has not been received, subject to a maximum reduction of 45% of the original exercise price.
- Term:** 10 years
- Exercisability:** Immediately exercisable, in whole or in part
- Transferability:** The warrants will not be subject to any contractual restrictions on transfer; provided that the UST may only transfer or exercise an aggregate of one-half of the warrants prior to the earlier of (i) the date on which the QFI has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings and (ii) December 31, 2009. The QFI will file a shelf registration statement covering the warrants and the common stock underlying the warrants as promptly as practicable after the date of this investment and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. The QFI will also grant to the UST piggyback registration rights for the warrants and the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the warrants and the common stock underlying the warrants. The QFI will apply for the listing on the national exchange on which the QFI’s common stock is traded of the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the warrants or the common stock.
- Voting:** The UST will agree not to exercise voting power with respect to any shares of common stock of the QFI issued to it upon exercise of the warrants.

Reduction: In the event that the QFI has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of common stock underlying the warrants then held by the UST shall be reduced by a number of shares equal to the product of (i) the number of shares originally underlying the warrants (taking into account all adjustments) and (ii) 0.5.

Consent: In the event that the QFI does not have sufficient available authorized shares of common stock to reserve for issuance upon exercise of the warrants and/or stockholder approval is required for such issuance under applicable stock exchange rules, the QFI will call a meeting of its stockholders as soon as practicable after the date of this investment to increase the number of authorized shares of common stock and/or comply with such exchange rules, and to take any other measures deemed by the UST to be necessary to allow the exercise of warrants into common stock.

Substitution: In the event the QFI is no longer listed or traded on a national securities exchange or securities association, or the consent of the QFI stockholders described above has not been received within 18 months after the issuance date of the warrants, the warrants will be exchangeable, at the option of the UST, for senior term debt or another economic instrument or security of the QFI such that the UST is appropriately compensated for the value of the warrant, as determined by the UST.