

Federal Programs Announced on October 14, 2008, to Enhance Market Liquidity and Bank Lending

Over the past several months, the federal government has reached deep into its arsenal of tools to calm the credit crisis and inject liquidity into the financial system. Today, acting in concert with the world's major economies, the Treasury Department, Federal Reserve and FDIC announced three significant steps to strengthen the capital position of U.S. financial institutions in an effort to spur interbank lending and unclog the credit markets:

- Creation of a *Capital Purchase Program* by the Treasury Department;
- Creation of an FDIC *Liquidity Guaranty Program*; and
- Refinement of the Federal Reserve's *Commercial Paper Funding Facility*.

Department of Treasury's Capital Purchase Program

Following the lead of its European counterparts, the Treasury Department has established a program to restore confidence and resuscitate interbank lending. The Capital Purchase Program ("CPP") will use up to \$250 billion of the \$700 billion rescue package recently authorized by Congress to invest directly in financial institutions.

Initially, nine banks -- Morgan Stanley, Goldman Sachs, Bank of America, Merrill Lynch, Wells Fargo, Citigroup, J.P. Morgan Chase, State Street, and Bank of New York Mellon -- will participate in the program and receive \$125 billion, collectively. However, the CPP is open to other institutions that request intervention prior to November 14, and the remaining \$125 billion under the plan will be reserved for these institutions.

Treasury's investment will be in the form of non-voting senior preferred shares constituting between 1 to 3 percent of an institution's risk-weighted assets (not to exceed \$25 billion). The preferred shares will pay a 5 percent annual dividend for five years, and a 9 percent annual dividend thereafter. Treasury will also receive warrants for common shares for up to 15 percent of the senior preferred investment.

In exchange, participating institutions must agree to certain restrictions on their activities and compensation structure:

- *Executive compensation* – for the life of the program, participating institutions must agree to the following limits on compensation to the CEO, CFO and next three highest paid executives:
 - Prohibition on any new golden parachute arrangements (existing severance packages remain intact)
 - Prohibition on any incentive compensation that is contingent on unnecessary and excessive risks that may threaten the institution
 - Clawback of any bonus or incentive compensation paid to senior executives based on statements of earnings or other criteria later proven to be materially inaccurate

- *Limitations on compensation tax deductions* – any executive compensation paid to these individuals that exceeds \$500,000 will not be tax deductible
- *Dividends* – current shareholder dividends cannot be increased without Treasury’s consent
- *Share repurchases* – participants may not repurchase shares held by investors other than Treasury for three years without Treasury’s consent

The Treasury Department is also developing a program to provide direct assistance to certain failing firms on a negotiated case-by-case basis.

FDIC’s Temporary Liquidity Guaranty Program

Second, the FDIC announced a new voluntary initiative, the Temporary Liquidity Guaranty Program (“TLGP”), to strengthen confidence and encourage interbank lending by (a) guaranteeing the senior unsecured debt of banks, thrifts, and holding companies and (b) providing unlimited FDIC insurance for non-interest bearing deposit transaction accounts.

The first component of the FDIC’s plan will fully backstop senior unsecured debt – including commercial paper, interbank lending, promissory notes, or unsecured debt -- issued on or before June 30, 2009, in the event that the issuing institution fails or if its holding company files for bankruptcy. Coverage would be limited to June 30, 2012, regardless of whether the maturity of the debt extends beyond this date. The backstop will be funded by a 75-basis point fee assessed to participating institutions.

The second component, coverage of non-interest bearing transaction accounts, expands the current \$250,000 FDIC insurance limit until the end of 2009 for participating institutions. These accounts primarily include payment-processing accounts such as business payroll. To pay for the expansion, participants will be charged an additional 10-basis point fee to their current FDIC insurance assessment. Fees on both TLGP programs will be waived for the first 30 days.

Federal Reserve’s Commercial Paper Funding Facility

Finally, the Federal Reserve announced further details on its Commercial Paper Funding Facility (“CPFF”), which provides a backstop for the commercial paper market. Beginning on October 27, 2008, and lasting until April 30, 2009, the CPFF will fund purchases of unsecured and asset-backed commercial paper with 3-month maturity from high-quality U.S. issuers and U.S. issuers with a foreign parent.

The CPFF will be structured as a credit facility to a special purpose vehicle (“SPV”) funded by the New York Fed. Eligible issuers must register with the CPFF starting October 20, 2008, and must sell eligible commercial paper to the SPV through the New York Fed’s primary dealers. To be eligible for purchase, the commercial paper must be rated A-1/P-1/F-1 by a major credit rating agency. Purchase price will be based on a pre-defined spread over the three-month overnight swap index rate on the day of purchase. The amount the SPV may purchase from any single issuer is limited to the amount of U.S. dollar-denominated commercial paper that the issuer had outstanding on any day between January 1 and August 31, 2008.