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Client Alert

Treasury Releases Application Materials, Term Sheets and Underwriting Standards for Tier 1 Capital Investments out of the Small Business Lending Fund

For more information regarding the Fund or for assistance in preparing an application packet, please contact:

John C. Vorys
614.464.6211
jcvorys@vorys.com

Elizabeth T. Farrar
614.464.5607
etfarrar@vorys.com

Anthony D. Weis
614.464.5465
adweis@vorys.com

Joshua R. Hess
202.467.8814
jrhess@vorys.com

On December 21, 2010, the U.S. Department of the Treasury ("Treasury") publicly released application materials, term sheets and underwriting standards for eligible financial institutions to apply for Tier 1 capital investments out of the $30 billion Small Business Lending Fund (the "Fund") appropriated to Treasury under the U.S. Small Business Jobs Act of 2010. The purpose of the Fund is to provide capital and incentives to eligible institutions to increase small business lending throughout the communities they serve. Importantly, the Fund is a distinct and separate program from TARP and, as a result, institutions receiving capital investments out of the Fund will not be treated as TARP participants.

Eligible Institutions

The financial institutions that are eligible to apply for Tier 1 capital include: (1) insured depository institutions with total consolidated assets of less than $10 billion that are not controlled by a bank holding company or savings and loan holding company and are not directly or indirectly controlled by any company or other entity that has total consolidated assets of $10 billion or more; and (2) bank holding companies or savings and loan holding companies with total consolidated assets of less than $10 billion. Asset levels are based on those reported in the financial institution's 4Q 2009 Call Report or Thrift Financial Report, as appropriate. Notwithstanding the foregoing categories, no financial institution will be eligible to apply if it (or, in the case of a holding company, any of its bank subsidiaries) is on the FDIC problem bank list (or similar list) at the time it applies to Treasury or has been removed from such list(s) within the 90 days preceding the date of its application.

Maximum Amount of Capital Investment

An eligible depository institution may apply to receive Tier 1 capital in an amount up to 5% of its risk-weighted assets ("RWA") if its total assets are $1 billion or less, or up to 3% of its RWA if its total assets are greater than $1 billion but less than $10 billion. An eligible bank holding company or savings and loan holding company may apply to receive Tier 1 capital in an amount up to 5% of its total consolidated RWA if its total consolidated assets are $1 billion or less, or up to 3% of its total consolidated RWA if its total consolidated assets are greater than $1 billion but less than $10 billion. RWA levels are based on those reported in the financial institution's most recent Call Report as of the date of application.

Application Procedures

By no later than March 31, 2011, an eligible institution wishing to apply for Tier 1 capital out of the Fund must submit an application to Treasury and a "small business lending plan" to its primary federal regulator and, if applicable, state regulator. If the institution is a holding company, it must also submit its small business lending plan to the primary federal regulator and, if applicable, state regulator of each of its insured depository institution subsidiaries. The applying institution is **not** to submit its small business lending plan to Treasury. Small business lending plans submitted by applying institutions will be deemed confidential supervisory information and will be used by Treasury and the regulators only in the context of the Fund. The application and the guide for preparing the small business lending plan are both available on Treasury's Website at www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx under the "Resources" column.

Decision, Closing and Term Sheets

Treasury will coordinate with the regulators to determine if an applying institution is eligible and qualified to receive a capital investment out of the Fund. Treasury may determine that the applying institution is qualified to receive a capital investment and issue a preliminary approval. Alternatively, Treasury could grant preliminary approval subject to the applying institution's ability to raise matching, private funds (with the amount of such funds determined by Treasury) from private, nongovernmental sources not otherwise applying for or receiving a capital investment out of the Fund. In such case, the amount of private funds required will be at least equal to the amount of the proposed capital investment. The matching private funds must have been raised after September 27, 2010, and must be subordinated to the rights of Treasury. Finally, Treasury could determine that the applying institution is not eligible to receive a capital investment, in which case the institution's application will be considered withdrawn.

If Treasury approves an application and the institution decides to proceed with closing, the parties will enter into a definitive letter agreement and securities purchase agreement, under which the recipient institution will issue senior perpetual noncumulative preferred stock or equivalents (the "Senior Preferred Stock"), liquidation preference of $1,000 per share, to Treasury in exchange for receiving the Tier 1 capital investment. The term sheets applicable to the Senior Preferred Stock are available on Treasury's Website at http://www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx under the "Resources" column. Importantly, a recipient institution must ensure that it has the authority under its charter documents to issue the Senior Preferred Stock prior to the recipient institution entering into the definitive agreements with Treasury.

Underwriting Requirements

The interagency underwriting requirements that recipient institutions must follow when using Fund capital to make small business loans are available on the Office of the Comptroller of the Currency's Website at http://www.occ.treas.gov/news-issuances/bulletins/2010/bulletin-2010-45.html under the "Related Links" tab at the bottom of the page.

Reporting of Qualified Small Business Lending

Recipients of Fund capital must submit quarterly supplemental reports that, among other things, report the institution's level of qualified small business lending ("QSBL") during the applicable quarter and calculate whether such level represented an increase over a baseline QSBL level equal to the quarterly average of its QSBL for the four quarters ending June 30, 2010 (the "QSBL Baseline").

QSBL is defined to include the following types of loans: (1) commercial and industrial loans; (2) owner-occupied nonfarm, nonresidential real estate loans; (3) loans to finance agricultural production and other loans to farmers; and (4) loans secured by farmland. Excluded from these types of loans, however, and therefore excluded from the calculation of the institution's QSBL, are (A) any loan or group of loans to the same borrower and its affiliates with an original principal or commitment amount greater than $10 million; (B) loans to borrowers who have (or whose ultimate parent company has) more than $50 million in revenues during the most recent fiscal year ended as of the date of loan origination; (C) the portion of any loans guaranteed by the U.S. Small Business Administration, any other U.S. Government agency or a U.S. Government-sponsored enterprise; and (D) the portion of any loans for which the risk is assumed by a third party (e.g., the portion of loans that have been participated).

Noncumulative Dividends

A recipient institution must pay quarterly noncumulative dividends on the Senior Preferred Stock. The rate of dividend to be paid for a given quarter will be based on the extent in which the institution's QSBL increased during such quarter over its QSBL Baseline. For the first nine quarters after the institution receives the capital investment, the dividend that it must pay will never be greater than 5%, and can decrease to as low as 1% depending upon the extent of the institution's increase in QSBL for the applicable quarter. If the institution's QSBL does not increase within the first nine quarters after the investment, then the dividend that it must pay will increase to 7% and will remain at such rate through the end of the first 4.5 years after the anniversary date of the investment. After 4.5 years, the dividend rate will rise to and remain at 9% until all of the Senior Preferred Stock has been fully redeemed by the institution.

Restrictions on Recipient Institutions and Rights of Treasury

The term sheets set forth a number of key provisions that recipient institutions will be subject to after receiving the Tier 1 capital, including:

1. *Missed Dividend Payments*. If a recipient institution misses any quarterly dividend payment on the Senior Preferred Stock, such institution must provide written notice to Treasury stating the rationale of the institution's board of directors for not declaring the dividend, and the institution will be prohibited, for that quarter and for the next three quarters thereafter, from repurchasing and from declaring or paying any dividends on any other senior preferred shares, junior preferred shares or common shares. After the fourth missed dividend payment, whether or not consecutive, if the institution was not at such time subject to a regulatory determination that it was prohibited from declaring and paying dividends, then the institution's board of directors must certify, in writing, that the institution used its best efforts to declare and pay such dividends in a manner consistent with safe and sound banking practices and the directors' fiduciary obligations. Upon the fifth missed dividend payment, whether or not consecutive, Treasury will have the right to appoint a representative to serve as an observer on the institution's board of directors, and such right will continue until the institution has made full dividend payments for four consecutive quarters thereafter. Finally, if the institution misses six or more dividend payments, whether or not consecutive, and if the amount of the capital investment was $25 million or more, then Treasury will have the right to appoint two members of the institution's board of directors, and will continue to have such right until the institution has made full dividend payments for four consecutive quarters thereafter.

2. *Dividends to Other Shareholders.* A recipient institution may declare and pay dividends to or redeem or repurchase equity securities from its other shareholders if the dollar amount of the institution's Tier 1 capital after giving effect to such payment, redemption or repurchase would be at least 90% of the amount of total Tier 1 capital that the institution had at the time of the capital investment out of the Fund (the "Tier 1 Dividend Threshold"), excluding any subsequent net charge-offs and redemptions to Treasury after the capital investment out of the Fund. During the period from the second anniversary of the capital investment until the day before the tenth anniversary, for every 1% increase in QSBL that the recipient institution has achieved above its QSBL Baseline, the Tier 1 Dividend Threshold will be decreased by a dollar amount equal to 10% of the amount of the original capital investment.

   A recipient institution's right to declare or pay dividends or redeem or repurchase equity securities from other shareholders is further restricted when the recipient institution is not a publicly traded company and has not repaid Treasury in-full by the end of the ninth quarter after the quarter in which the capital investment was made. In such case, the recipient institution will be prohibited from declaring or paying any dividends or redeeming or repurchasing any equity securities from its other shareholders until the capital investment is repaid in-full.

3. *Ranking with Respect to Distributions.* The Senior Preferred Stock will rank senior to the recipient institution's common shares and *pari passu* (on equal footing) with all existing preferred shares (other than junior preferred shares, if any).

4. *Voting Rights.* The Senior Preferred Stock will be nonvoting **except with respect to**: (a) any authorization or issuance of shares ranking senior to the Senior Preferred Stock; (b) any amendment to the rights of the Senior Preferred Stock; and (c) any merger, exchange, dissolution or similar transaction which would affect the rights of the Senior Preferred Stock. Additionally, there could be further rights granted to the holder of the Senior Preferred Stock under relevant State law. For example, under Ohio law, the holder of the Senior Preferred Stock will also have voting rights on certain matters reducing or eliminating the capital of the recipient institution, changing the purpose(s) of the recipient institution or changing the recipient institution into a nonprofit corporation.

5. *Transferability.* There will be no transfer restrictions on the Senior Preferred Stock. A recipient institution may merge or sell all, or substantially all, of its assets so long as the rights of the Senior Preferred Stock and the obligations of the institution with respect thereto are assumed by the successor entity and equivalent securities are issued by the successor entity.

6. *Access and Information.* Upon reasonable notice, the holder of the Senior Preferred Stock, the holder's designees, the Inspector General of the Treasury and/or the Comptroller General of the United States will have the right to examine the recipient institution's corporate books and discuss all matters relevant to the investment with the institution's principal officers.

Executive Compensation Restrictions

There will be **no** executive compensation restrictions or warrant obligations imposed on recipient institutions.

Redemption

Recipient institutions may, with prior regulatory approval, redeem the Senior Preferred Stock and pay all accrued but unpaid dividends for the quarter in which the redemption occurs. Redemption must occur at a per share price equal to 100% of the Senior Preferred Stock's liquidation preference. Partial redemptions are permitted so long as in an amount equal to at least 25% of the number of originally issued shares of Senior Preferred Stock.

TARP Participants

A financial institution that is currently participating in the TARP Capital Purchase Program ("TARP CPP") or TARP Community Development Capital Initiative ("TARP CDCI") (such financial institution being referred to as a "CPP/CDCI Participant") is still eligible to apply to receive a capital investment out of the Fund so long as the institution meets all of the eligibility requirements outlined above and (1) redeems all outstanding securities issued under TARP CPP or TARP CDCI or applies to refinance such securities through the Fund, (2) is in material compliance with all TARP CPP and/or TARP CDCI agreements, and (3) is current on its TARP CPP or TARP CDCI dividend payments and has not missed (or been more than 60 days late in paying) more than one of such dividend payments in the past.

CPP/CDCI Participants will, however, be subject to additional restrictions, fees and investment terms if they wish to receive Fund capital, including:

1. *Amount of Capital Investment.* For CPP/CDCI Participants with total assets of $1 billion or less, they may apply to receive a capital investment of no less than 1% of RWA and no more than 5% of RWA (regardless of whether such amount exceeds the aggregate investment amount received under TARP CPP or TARP CDCI). For CPP/CDCI Participants with total assets of more than $1 billion but less than $10 billion, they may apply to receive a capital investment of no less than 1% of RWA and no more than 3% of RWA (again regardless of whether such amount exceeds the aggregate amount received under TARP CPP or TARP CDCI).

2. *Lending Incentive Fee.* A CPP/CDCI Participant receiving Fund capital will be subject to a lending incentive fee of 2% per annum of its outstanding Fund capital if, as of the beginning of the tenth full quarter after the date of investment, the CPP/CDCI Participant's QSBL has not increased relative to its QSBL Baseline. This lending incentive fee will be owed starting on the fifth anniversary of the CPP/CDCI Participant's CPP investment, and will continue until 4.5 years after the date of investment.

3. *Warrants.* Any warrants issued by a CPP/CDCI Participant under TARP CPP or TARP CDCI that are outstanding as of the date of the capital investment out of the Fund shall remain outstanding unless repurchased by the CPP/CDCI Participant. CPP/CDCI Participants will not, however, be required to issue additional warrants to Treasury in order to receive Fund capital.

The term sheets applicable to the Senior Preferred Stock to be issued to Treasury by CPP/CDCI Participants receiving Tier 1 capital out of the Fund are available on Treasury's Website at http://www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx under the "Resources" column.
