WINSTON & STRAWN LLP

BRIEFING

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SEC Provides Guidance for Financial Institutions Filing Proxy Statements in Connection with the TARP Capital Purchase Program

On November 24, 2008, the staff of the SEC Division of Corporation Finance (the “Division”) published guidance (the “Guidance”) for financial institutions that participate in the Capital Purchase Program (the “CPP”) under the U.S. Department of Treasury (the “Treasury”) Troubled Asset Relief Program (“TARP”). In particular, the Guidance is directed to institutions that may be required to file proxy statements on Schedule 14A or information statements in connection with the issuance of securities under the CPP.

Background

The CPP was established by the Treasury under the Emergency Economic Stabilization Act of 2008 (“EESA”) to provide funding to eligible financial institutions. In order to participate in the CPP, a financial institution must agree to issue certain preferred securities and warrants to the Treasury. Financial institutions that plan to issue such securities may be required to seek shareholder approval before doing so, and federal securities laws may require the filing of a proxy statement on Schedule 14A or an information statement when soliciting such approval.

The Guidance

The Guidance reflects the Division’s recognition of the time constraints involved in soliciting shareholder approval and completing a CPP funding transaction. In an effort to assist financial institutions that may be preparing such proxy statements, and to expedite the review process, the Guidance includes a list of comments issued in connection with similar proxy statements already reviewed or in the process of being reviewed. However, the Division was careful to note that the comments included in the Guidance may or may not be relevant to a particular filing depending on relevant facts and circumstances, and the list may not address all material disclosure items that should be presented to shareholders in any specific situation. Nevertheless, the list of comments provides a good starting point for financial institutions that have applied to participate in the program and will be required to obtain shareholder approval in order to close the transaction. Institutions submitting filings that fail to address the relevant items in the Guidance could receive the same comments from the Division when it reviews their filings, delaying the approval process.

Sample Comments

According to the sample comments, a financial institution’s proxy statement should discuss why the institution plans to participate in the CPP or is considering doing so, as well as how this participation may:

- impact holders of outstanding senior classes of the institution’s securities;
- impact the rights or dilute the interests of existing common shareholders;

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- require expansion of the institution's board to accommodate any Treasury appointees;
- require the institution to register the securities issued to the Treasury for resale; and
- impact how the institution operates.

A financial institution's proxy statement also should disclose whether the institution has applied to participate in the CPP and the status of such application, the material terms of its participation (with a description of the material terms of the securities to be issued to the Treasury), the estimated proceeds of the proposed sale to the Treasury, and the expected use of those proceeds.

The Guidance also suggests that institutions disclose (if true) that the Treasury is not obligated to accept the CPP application and that the estimated proceeds are not guaranteed. Other topics for discussion are the material effects on liquidity, capital resources, or results of operations if the Treasury denies the application, and whether the institution will modify any plans or contracts to comply with EESA limits on executive compensation. The Guidance also notes that Item 13 of Schedule 14A requires financial information to be included in a proxy statement if an institution is seeking authorization to issue common or preferred stock under certain circumstances, and that the Division staff has commented that, if an institution has not included financial information in its proxy statement, it should explain why it believes that financial statements are not material in connection with issuing the securities.

Pro Forma Financial Statements

The Guidance also includes sample comments that may assist financial institutions in evaluating financial statement requirements, including:

- If the proceeds of the sale of securities to the Treasury are expected to have a material impact on the balance sheet or income statement, and the institution is therefore required by rule to provide, in the proxy statement, pro forma statements that comply with Article 11 of Regulation S-X, a textual discussion of the pro forma effect may be provided instead.
- In evaluating the impact of the potential sale of securities to the Treasury, the institution must consider the material effects of the transaction including how application of the proceeds may affect net interest margin, how accretion and dividends on preferred stock will impact net income available to common shareholders, and how the transaction will impact basic and diluted earnings per share and diluted shares outstanding.
- Assumptions regarding the use of proceeds must be factually supportable and only plans for the proceeds that meet factually supportable criteria should be considered.
- If the proceeds of the sale of securities to the Treasury will have a material impact on the institution's balance sheet or income statement, and the institution provides pro forma financial statements in the proxy statement, it should include a pro forma balance sheet for the most recent balance sheet date and a pro forma income statement for the most recent annual and interim periods, addressing the impact of both minimum and maximum sale proceeds. In preparing pro forma financial statements, the institution should:
    - discuss relevant assumptions, with a brief description of any pro forma adjustments, such as assumptions about interest savings on proceeds applied to pay down debt and interest income earned on proceeds invested;
    - state (if true) that the institution used the Treasury stock method to evaluate the effect of the warrants on diluted shares outstanding; and
    - describe the methodologies used to allocate transaction proceeds among securities that may be issued to the Treasury (relative fair value) and to accrete the discount on preferred stock.
- If a textual discussion is provided in lieu of pro forma financial statements, the institution should address the minimum and maximum proceeds of the sale, as well as the items in the previous paragraph.

Finally, the Guidance provides that if a financial institution does not believe that the sale of the securities to the Treasury will have a material impact on its balance sheet or income statement, the institution should provide the Division with its quantitative and qualitative analysis supporting that conclusion and, in the analysis, discuss the impact on each of the items noted above, as well as on total shareholders' equity and the institution's capital ratios.

The Guidance can be found at *http://www.sec.gov/divisions/corpfin/cffilingguidance.htm*.

The Financial Services Practice Group of Winston & Strawn represents a broad range of financial institutions on all regulatory matters, including matters under the EESA and TARP. If you have any questions regarding the matters discussed in this Briefing, or if you need assistance in developing and/or reviewing filings relating to the matters covered by this Briefing, please contact any of the Winston & Strawn attorneys listed below or your usual Winston & Strawn contact:

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