



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

SCOTT G. ALVAREZ  
GENERAL COUNSEL

December 7, 2012

Joseph J. Samarias, Esq.  
Chief Counsel  
Office of Financial Stability  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Dear Mr. Samarias:

Your office has inquired regarding whether an investor that purchases preferred shares that were issued by banking organizations to the Department of the Treasury (“Treasury”) as part of the Troubled Asset Relief Program’s (“TARP”) Capital Purchase Program (“CPP”) (“CPP shares”) would be required to obtain the prior approval of the Board under the Bank Holding Company Act (“BHC Act”),<sup>1</sup> the Home Owners’ Loan Act (“HOLA”),<sup>2</sup> or the Change in Bank Control Act (“CIBC Act”) in certain situations.<sup>3</sup> We understand that this question arises in connection with Treasury’s plan to package the CPP shares of a number of banking organizations (“CPP firms”) into portfolios that will then be sold through an auction process.<sup>4</sup>

Section 3 of the BHC Act, section 10(e) of HOLA, and the accompanying Board rules, require companies to seek the prior approval of the Board in order to acquire control of a bank or bank holding company, or a savings association or savings and loan

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<sup>1</sup> 12 U.S.C. § 1841 et seq.

<sup>2</sup> 12 U.S.C. § 1461 et seq.

<sup>3</sup> 12 U.S.C. § 1817(j).

<sup>4</sup> Alternatively, Treasury has allowed CPP firms to designate a third party institution to participate in an individual auction to acquire up to 100 percent of the CPP firm’s CPP shares. These transactions are not addressed in this letter and may require the prior approval of the Board or another Federal banking agency under the CIBC Act, the BHC Act, or HOLA. Investors purchasing CPP shares through individual auction should consult with Board staff, and staff at other Federal banking agencies as appropriate, regarding actions necessary to comply with these Acts.

holding company, respectively (each, a “banking organization”).<sup>5</sup> These sections also require existing bank holding companies and savings and loan holding companies to seek the prior approval of the Board in order to acquire more than 5 percent of any class of voting securities of any other banking organization.<sup>6</sup> The CIBC Act and its accompanying rules require persons, including individuals acting in concert, to provide at least 60 days’ notice to the appropriate Federal banking agency prior to acquiring 10 percent or more of any class of voting securities of a banking organization if those shares are registered under the securities laws or, if not registered, there is no larger shareholder.<sup>7</sup>

The CPP shares are a unique class of securities, acquired by Treasury under the Emergency Economic Stabilization Act of 2008 to provide capital to institutions during the financial crisis. You have represented that there is a strong public policy interest in facilitating Treasury’s exit from CPP share ownership and restoring the CPP institutions to full non-government ownership.

#### *Voting securities*

As noted above, under the specific terms of the BHC Act, HOLA, and CIBC Act, application of those Acts is determined based on ownership of a given percentage of any class of voting securities. Prior approval from, or notice to, the Board or another Federal banking agency would be required in accordance with the terms of those Acts and the implementing regulations if the relevant thresholds for the acquisition of voting shares are met.

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<sup>5</sup> The BHC Act and HOLA provide that a company has control over a banking organization if (i) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the banking organization; (ii) the company controls in any manner the election of a majority of the directors or trustees of the banking organization; or (iii) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the banking organization. 12 U.S.C. § 1841(a)(2); 12 U.S.C. § 1467a(a)(2). Additionally, an acquiror will be deemed to control a banking organization under HOLA if they have contributed more than 25 percent of the capital of the company. 12 U.S.C. § 1467a(a)(2)(B).

<sup>6</sup> 12 U.S.C. § 1842(a)(3); 12 U.S.C. § 1467a(e)(2).

<sup>7</sup> 12 CFR 225.41(c)(2); 12 CFR 238.31(c)(2).

You have asked how the Board would view the acquisition of CPP shares that are non-voting preferred shares under ordinary circumstances.<sup>8</sup> You have also indicated that by the terms of the CPP shares, if a CPP firm fails to pay the assigned dividend on the CPP shares for 6 quarters or more, whether or not consecutive, the CPP shareholders are entitled to appoint or elect two directors to the banking organization's board of directors. As with other preferred shares, the special voting rights attendant to the CPP preferred shares allow the holders to vote as a class for directors separate from the owners of the common and other voting shares.<sup>9</sup>

The Board has long held that nonvoting preferred shares that gain voting rights as the result of the nonpayment of dividends would be considered voting shares for purposes of the BHC Act for any period that the voting rights are triggered.<sup>10</sup> Accordingly, under the terms of the BHC Act, HOLA, and CIBC Act, a person (or, where appropriate, group of persons acting together) that seeks to acquire all of the CPP shares for a particular institution where the voting rights for the shares have been triggered would be considered to be seeking to acquire 100 percent of a class of voting shares and would be required to obtain prior approval or provide prior notice in accordance with the requirements of the applicable Act.

In limited circumstances, the Board has not considered preferred shares with rights similar to those active under the CPP shares to be voting securities for purposes of the BHC Act where the holder of preferred shares with special voting rights commits not to exercise the voting rights without the prior approval of the Board.<sup>11</sup> Given the similarity of the terms of the CPP shares to those previously considered by the Board, staff would recommend that the Board not consider the CPP shares to be "voting securities" for purposes of the BHC Act, HOLA, or the CIBC Act in the hands of a successful bidder so long as the bidder commits to the Board in writing not to exercise any right provided in a CPP share certificate of designation to select a person to the board of directors of a CPP firm.<sup>12</sup>

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<sup>8</sup> At CPP firms that are organized as S-Corporations, Treasury holds its CPP interest as subordinated debt that functions as equity.

<sup>9</sup> The CPP shareholders would have this right together as a single class with holders of shares of any other class of voting parity stock, if any.

<sup>10</sup> 49 Federal Register 794, 800 (1984).

<sup>11</sup> Id.

<sup>12</sup> This would not disturb the presence of a director that has previously been selected by the Treasury during the term of that selection, but not allow the holder to participate in reappointing that (or another) director.

*Total equity*

A second test under the BHC Act and HOLA is based on the ability of the owners of securities of a banking institution to exercise a controlling influence over the institution.<sup>13</sup> For purposes of the BHC Act and HOLA, the Board has considered the overall size of an equity investment, including both voting and nonvoting equity, as an important indicator of whether the investor may have the ability to exercise a controlling influence over the institution in a manner that requires prior approval of the Board. These thresholds are explained in the Board's policy statement on equity investments in banks and bank holding companies.<sup>14</sup>

In several cases, the Treasury acquired CPP shares that, either at the time of acquisition by Treasury or subsequent to the acquisition by Treasury, represent more than 25 percent of the equity of the CPP firm. Treasury now seeks to divest these interests to investors that propose to hold the shares in pools without attempting to exercise control over the CPP firm for purposes of the BHC Act or HOLA.<sup>15</sup>

Given the unique and limited nature of the CPP shares, the role of the Treasury in acquiring the shares, and the public interest in the sale of the shares to protect taxpayers, among other things, Board staff would not recommend that the Board find successful bidders for a portfolio of CPP firms to have a controlling influence over the management or policies of the banking organizations for purposes of the BHC Act or HOLA based solely on the acquisition of CPP shares from the Treasury that exceed the total equity limits outlined in the Board's Policy Statement, provided the acquirors agree to certain limitations. In particular, to avoid exercising a controlling influence, acquirors must agree that all CPP shares be and remain nonvoting (i.e., the shares have no voting rights and/or the acquiror has committed to the Board as explained in this letter to waive the right to select a director in the event of a default in dividend payments) while held by

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<sup>13</sup> 12 U.S.C. § 1841(a)(2)(C); 12 U.S.C. § 1467a(a)(2)(D).

<sup>14</sup> <http://www.federalreserve.gov/newsevents/press/bcreg/20080922c.htm> ("Policy Statement").

<sup>15</sup> CPP firms may seek to redeem the CPP shares in connection with, or subsequent to, the sale of their CPP shares to an investor. Bank holding companies must give the Board prior written notice for any redemption of its equity securities that exceeds 10 percent of the company's consolidated net worth (including other redemptions within the preceding 12 months). 12 CFR 225.4(b). CPP firms also may otherwise have prior review or approval requirements for redemptions as a result of formal or informal enforcement actions, supervisory guidance, or the rules or regulations of other Federal banking agencies.

the acquiror. The acquiror would be expected to make other commitments to the Board similar to those relied on by the Board in allowing others to acquire significant equity positions in banking organizations. Those commitments, attached in the Appendix, generally prohibit the acquiror from obtaining representation on the board of directors of the banking organization, limit the acquisition of voting securities by the acquiror, and limit the business relationships the acquiror may have with the banking organization. To the extent that the director election provision for the CPP shares has been triggered (notwithstanding any waiver submitted to the Board), the acquiror would be expected to limit the transfer of those shares to (a) affiliates, (b) widespread public distributions, (c) transfers in which no transferee (or group of transferees) would receive 2 percent or more of any class of voting securities of the bank or other company, (d) transferees that would control more than 50 percent of the voting securities of the CPP firm without any transfer from the acquiror; or (e) transferees from which the Board has accepted a waiver of the right provided in a CPP share certificate of designation to vote for one or more representative to serve on the board of directors of the CPP firm.<sup>16</sup>

#### *Reservation of Authority*

The views expressed in this letter represent only the views of staff and do not bind the Board. These views are also limited to the circumstances described in this letter and are based on the unique circumstances and strong public interest raised by Treasury's proposal to sell its shares of banking organizations acquired in the CPP program. The advice in this letter would apply only to persons acquiring a portfolio of CPP shares directly from the Treasury as part of an auction. Third parties that seek to acquire shares from these initial acquirors may not rely on this letter without consultation with Board staff. Moreover, parties may not, without the agreement of the Board or its staff, rely on this letter for any other acquisition of shares beyond the acquisition of a portfolio of CPP shares from Treasury by auction. Finally, acquisitions may require the prior approval of another Federal banking agency under the CIBC Act, the BHC Act, or HOLA, notwithstanding the advice described in this letter. Investors seeking to rely on this letter should discuss the terms of the letter with Board staff.

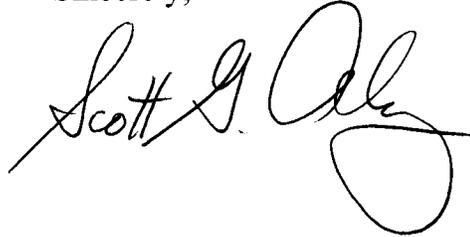
This letter is based on the information provided by the Treasury, and any change in the terms or facts may result in a different view. If you have any questions

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<sup>16</sup> This letter does not address situations where the holders of CPP shares seek to change the characteristics of the CPP shares through conversion, exchange or otherwise.

about this matter, please contact Amanda Allexon, Senior Counsel (202-452-3818), or Alison Thro, Assistant General Counsel (202-452-3236), of the Board's Legal Division.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott G. Allen". The signature is written in a cursive style with a large, looped initial "S" and a distinct "A" at the end.

Attachment

cc: Ian Lampl, Esq., Deputy Chief Counsel,  
Office of Financial Stability, Department of the Treasury

## Appendix

In connection with its purchase of preferred shares that were issued by banking organizations (“CPP firms”) to the Department of the Treasury as part of the Troubled Asset Relief Program’s Capital Purchase Program (“CPP”) (“CPP shares”), [Acquiror Name], [city, state], and its subsidiaries and affiliates (collectively, “[Acquiror Name]”), will not, without the prior approval of the Board or its staff, directly or indirectly:

- (1) Exercise any right provided in a CPP share certificate of designation for a CPP firm to vote for or otherwise select one or more representative to serve on the board of directors of a CPP firm, or any of its subsidiaries;
- (2) Exercise or attempt to exercise a controlling influence over the management or policies of the CPP firm or any of its subsidiaries<sup>17</sup>;
- (3) Have or seek to have a representative serve on the board of directors of a CPP firm or any of its subsidiaries;
- (4) Have or seek to have any employee or representative serve as an officer, agent, or employee of a CPP firm or any of its subsidiaries;
- (5) Take any action that would cause a CPP firm or any of its subsidiaries to become a subsidiary of [Acquiror Name];
- (6) Own, control, or hold with power to vote any voting securities of a CPP firm or any of its subsidiaries (including any securities owned or controlled by the officers and directors of the [Acquiror Name]);
- (7) Propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of a CPP firm or any of its subsidiaries;
- (8) Enter into any agreement with a CPP firm or any of its subsidiaries that substantially limits the discretion of CPP firm’s management over major policies and decisions, including, but not limited to, policies or decisions about employing and compensating executive officers; engaging in new business lines; raising additional debt or equity capital; merging or consolidating with another firm; or acquiring, selling, leasing, transferring, or disposing of material assets, subsidiaries, or other entities;

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<sup>17</sup> A complete list of CPP firms is included in the Attachment.

- (9) Solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of a CPP firm or any of its subsidiaries;
- (10) Dispose or threaten to dispose (explicitly or implicitly) of equity interests of a CPP firm in any manner as a condition or inducement of specific action or non-action by a CPP firm or any of its subsidiaries;
- (11) To the extent that director election rights for the CPP shares have been triggered (notwithstanding any waiver accepted by the Board), transfer CPP shares except (a) to an affiliate of [Acquiror Name] or the CPP firm; (b) in a widespread public distribution; (c) in transfers in which no transferee (or group of transferees) would receive 2 percent or more of any class of voting securities of the CPP firm; (d) to a transferee that would control more than 50 percent of the voting securities of the CPP firm without any transfer from [Acquiror Name]; or (e) to a transferee from which the Board has accepted a waiver of the right provided in a CPP share certificate of designation to vote for one or more representative to serve on the board of directors of the CPP firm;
- (12) Enter into any other banking or nonbanking transactions with a CPP firm, except that the [Acquiror Name] may establish and maintain deposit accounts with a CPP firm, provided that the aggregate balance of all such deposit accounts does not exceed \$500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with a CPP firm.

The terms used in these commitments have the same meanings as set forth in the Bank Holding Company Act of 1956, as amended (“BHC Act”), and the Board’s Regulation Y. Nothing in these commitments releases the [Acquiror Name] from compliance with the BHC Act, the Home Owners’ Loan Act, or the Change in Bank Control Act of 1978, as amended, and any regulations thereunder for any subsequent acquisition or increase in the percentage ownership of any class of voting shares of a CPP firm.

Each [Acquiror Name] understands that these commitments constitute conditions imposed in writing in connection with the Board’s findings and decisions related to [Acquiror Name]’s acquisition of CPP shares of the CPP firms, and, as such, may be enforced in proceedings under applicable law.