

TRUST PREFERRED SECURITIES INDENTURE SETTLEMENT

*Offer of Compromise Program*

WHITE PAPER DISCUSSION



*balancing the scale*

Monday, July 8, 2013

Trust Preferred Securities / Trust Indenture  
“Offer of Compromise Program”  
Information for Community Banks

Confidential for discussion purposes only

## The situation / Trust Indenture and Trust Preferred Securities

For Community Bank Holding Companies (BHC) the indenture to a Statutory Trust to issue Preferred Securities almost always offers a 5 year deferral period on interest payments. This was insisted on by the FDIC when Trust Preferred Securities (TruPS) were initially used by bank holding companies to raise capital. In theory this feature helped make the TruPS eligible to be Tier 1 Capital.

The other features of the indenture are fairly benign. However, the interest deferral feature can create a large liability for a bank holding company. Many BHCs are deferring interest, and this deferred interest is usually on the balance sheet as accrued interest payable. At the end of the 5 year deferral the accrued interest is due and payable in one lump sum or the BHC goes into default.

Investors / Holders of these TruPS do NOT want a default.

## Institutions that can benefit from Offers of Compromise

- Community Bank Holding Companies
  - o Owning Banks with less than \$750 million in assets
  - o More than \$2.0 million in Trust Indenture Obligation(s)
  - o Relying on an interest deferral period
  - o Typically with less than 2 years remaining on deferral eligibility
  - o Now under or recently under some Consent Order or Memorandum of Understanding (MOU)
    - ◆ With limited availability of cash in the BHC
  - o Trends of decreasing
    - ◆ NPAs
    - ◆ OREO
  - o Trends of increasing

- ◆ Operational profits

## The Plan to Offer a Compromise

- Structuring a plan and determining the best tactics to optimize the possibility of success requires these important tasks to be accomplished
  - o The first task is to trace all contacts in the chain of guarantor / issuer / trustee / management / ownership
    - ◆ The task of finding the contacts for each party along the chain leading to the decision makers is not complicated, but is tedious
    - ◆ Our associates are experienced and our contact database gives us the best chance to reach decision makers
      - An associate is assigned to a client and begins making calls and initiating emails, working through the Trustee, legal representatives and securities brokers
      - Common links are found in the chain that can be utilized to find the ultimate decision makers
        - o Often the decision maker (depending on the type of compromise requested) is the manager of a Collateralized Debt Obligation (CDO) or Investment Group
          - ◆ These managers often have Power of Attorney to handle some level of compromise
        - o Our experience shows that approximately 20% of TruPS are owned in “Passively Managed” Collateralized Deposit Obligation pools
          - ◆ A “Passively Managed” pool is impossible to deal with since Management of such a pool has limited authority to do anything except collect interest and principal

- o The balance of issued and outstanding TruPS are owned by: individual investors, corporate investors, Banks, other financial institutions or Actively Managed CDOs
  - ◆ Discussions with these managers/owners can still be tricky, but in most cases there is a path to avoid default
    - Investors and financial institutions are the easiest to have discussions with, and the most reasonable about possible interest or principal forgiveness
    - CDOs are difficult to deal with because they are made up of a large number of investors and there may be a requirement for the pool to obtain the approval from each investor
  - If the TruPS are owned in a “Passively Managed Pool” we would discontinue the process and work towards a plan to pay in full or a potential re-organization of the BHC
- o Once we know the players, or at least the type of entities each are, we will have a good idea how to proceed
- o The next task is a comprehensive review of the BHC and Statutory Trust
  - ◆ Financials
    - Audited statements for each
      - o 3 fiscal year end statements and most recent interim statement

- ◆ Legal documents
  - Indenture
  - Placement agreement
  - Legal status
  - Guarantee agreement
  - Deferral notification
  - Other
- o Our next task is a detailed discussion with Senior Management at the BHC during which we hope to produce a reasonable offer of compromise
- o The last task in this phase is initiating a conversation with the Investment Manager or Owner of the TruPS
  - ◆ This is difficult and may require involvement of legal council on each side

## **Tasks after location and initial conversation**

- The number of parties involved in the issuance and ownership of TruPS makes the process complicated, therefore the BHC / Consultant must work through the proper channels to contact the owner
  - o We work with the following parties (additional fees may be charged by each)
    - ◆ Bank Holding Company (you)
    - ◆ Statutory Trust
    - ◆ Alston Bird or other chosen legal council
    - ◆ Trustee
    - ◆ Trustee's legal council
    - ◆ Owner of TruPS, could be anyone of the following

- Individual investor
- Corporate investor
- Bank or Financial institution
- Or they could be part of a Collateralized Debt Obligation (CDO)
- The task now is to formalize the “Offer of Compromise” and present it through our legal council to the Trustee with a requirement that it be forwarded to the Investment Manager and / or Owner for approval
  - o Since CDOs have such complicated ownership and management structures they typically will only entertain a single offer of compromise at a time
    - ◆ The offer must take the form including complete legal documentation, presented to the Investment Manager or Owner
      - This will allow them the opportunity to make a simple yes/no decision
  - o If we are working directly with a single owner the process is less complicated but often more contentious
- The most difficult task is “babysitting” the paperwork as it is presented to the parties that are needed to approve
  - o Typically several weeks are spent talking on the phone and or trading emails with the parties along the chain
  - o In most cases a face to face trip to see the Investment Manager is necessary
    - ◆ Usually a representative from MOGO will handle this trip
      - However in some cases it is good for others to attend
        - o BHC officer

- o legal council
- o Trustee
- ◆ In some cases additional trips to visit downstream owners are necessary
- Finally we hope to receive a decision from the Investment Manager(s) / Owner(s) regarding their acceptance of the offer
  - o This will typically come in the form of the Document package(s) duly executed, returned to us
    - ◆ The BHC can then make appropriate marks to its financials
      - Rarely do the Investment Manager(s) / Owner(s) make a counter offer; they either accept or reject the Offer of Compromise
  - o Should the Investment Manager(s) / Owner(s) reject the offer, you can decide to go back through with another offer or discontinue the process and prepare for paying in full or entering default

## **Disadvantages for Investor / Fund / Securities Holder**

- Actual financial loss realized

## **Advantages for Investor / Fund / Securities Holder**

- Avoids costly default procedure
- Potentially can recover past investment write down losses
- Avoids possibility of BHC going directly back into deferral mode
- Stabilization of future cash flows from investment

## **Disadvantages for Bank Holding Company**

- There is some risk in the initial costs
  - o Consultant

- o legal council representing BHC
  - o Trustee Fees
  - o legal council representing Trustee
  - o Owner/manager of TruPS may want some cost offset
- Settlement offer could be rejected
- Depending on type of forgiveness, BHC could be asked to give up future deferral rights

## **Advantages for Bank Holding Company**

- New Capital
- Improved liquidity
- Costs of this type of settlement are relatively low
- Infusion of New Capital should insure survival and growth
- Settlement of TruPS could improve BHCs ability to attract additional investors if needed