



## Preparing the Proxy in Troubled Times

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### Shortcomings

Today's banking crisis has revealed shortcomings in the corporate and financial management of some community and regional banks magnified by the precipitous drop of their bank stock prices and in the most troubled institutions, the need to augment equity capital. These shortcomings include: (i) an insufficient number of shares of authorized "Blank Check Preferred Stock" and / or "Common Stock"; (ii) unfamiliarity with preemptive rights; (iii) excessive "strike prices" in Shareholder Rights Plans; (iv) absence of Dividend Reinvestment Plans and direct Shareholder Stock Purchase Programs; (v) the absence of leveraged Employee Stock Ownership Plans, and (vi) the continued payments of cash dividends in the face of economic turmoil at a time when "Capital is King". Some or all of these items should be addressed in forthcoming Annual or Special Shareholders' Meetings.

### Regulatory Capital Requirements Became Capital Ceilings, Not Capital Floors

Minimum regulatory capital requirements became capital ceilings, not capital floors for some community banks, especially in growth and then depressed markets, resulting in crisis. The need for Core Elements of Tier I Regulatory Capital consisting of Common equity and Non-cumulative preferred stock by the Nation's largest banks can be attributed to their excessive reliance upon defective financial engineering of collateralized securities; non-transparent accounting that failed to demonstrated their full exposure to Special Investment Vehicles and collateralized commercial paper facilities and the sponsor's contractual and moral commitments to fund their affiliates in distressed markets, and the opacity of their financial condition and underlying credit exposure. Others suffer from excessive leverage attributed to acquisition programs that sought to maximize earnings per share at the expense of tangible common equity; excessive use of tax-advantaged Tier I Trust Preferred Stock, or TRUPs; introduction of "double leverage", that is the investment of Parent company debt in bank equity; errors of commission or omission attributed to excessive investment in CDOs' and other collateralized securities that became impaired; the incomprehensible failures of "Government Sponsored Enterprises", and finally, the ever present credit cycle.

The government responded instituting remedies (TARP Capital Purchase Program) that are reminiscent in many ways of the 1930's era Reconstruction Finance Corporation's bank equity purchase program, first employed in the "Not So, Great

Depression". The RFC invested \$52 billion (\$768 billion in current dollars), into banks and the economy that successfully augmented bank capital, but was not successful in making bank credit available. Banks then, as now, hoarded capital and simply would not lend into a depressed economy.

The U.S. Treasury's TARP Capital Purchase Program contemplates the purchase of 5% Senior Preferred Stock, payable quarterly, with companion 10 year Warrants equal to 15% of redemption value priced at the issuing bank's 20-day trailing average stock price, of not less than 1% nor more than 3% of the issuing bank's risk assets. The security has two punitive features including a dividend that "Step-ups" after five years to 9%, and if shareholders' failed to authorize sufficient common stock, a Warrant whose exercise price "Steps-down" resulting in still more shares of common stock being issued. The TARP Preferred Stock is economically attractive and should be considered "Bridge Capital" by participating banks, especially if one trades at a premium to tangible book value! Applications must be submitted by November 14, 2008.

### Recommendations

We recommend as appropriate, that banks authorize: (i) 50 million shares of Blank Check Preferred; (ii) 100 million shares of Common Stock; (iii) keep Preemptive Rights optional; (iv) employ qualified advisors to assess the need for and "strike price" of a Shareholder Rights Plans; (v) institute Dividend Reinvestment Program, or DRIPs and Shareholder Stock Purchase Plans with modulation of any stock price discount, as capital is required; (vi) reflect current stock market realities in all Stock Incentive and Option Programs; (vii) contemplate the added benefits and costs of a Leveraged ESOP that enfranchises employees; and (viii) pay Stock Dividends in lieu of higher Cash Dividends that would be otherwise prohibited by banks issuing TARP Preferred Stock anyhow.

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