

Client Alert

Jointly prepared by Goodwin Procter's Private Equity and Financial Services Groups

New Opportunity, Potential Dangers, for Private Equity Investments in Banks

Secretary of the Treasury Paulson announced this morning that the Treasury Department is contemplating a new capital purchase program (CPP) for investing additional TARP funds in banks and, potentially, non-bank financial institutions. That program potentially will include a requirement that a matching investment of private capital be raised by institutions seeking TARP funds under the new CPP. Such a program could offer an attractive opportunity for private equity funds focused on financial institutions to put capital to work alongside a cushion of attractively-priced financing from the Treasury Department. To date, some funds have found deal flow challenging due, in part, to the competition represented by the government's relatively inexpensive money. A private investment requirement or recommendation as part of a new CPP could bring a spate of potential new deals creating a favorable buyer's market.

With opportunity, though, also comes risk. Funds contemplating investing alongside the new CPP need to carefully consider the potential downside of co-investing with the government, particularly in light of Section 5.3 of the Treasury Department's form of Securities Purchase Agreement for the current CPP. Section 5.3 is the amendment provision which includes the unusually broad proviso: "the Investor [i.e., the Treasury Department] may unilaterally amend any provision of this Agreement to the extent required to comply with any changes after the Signing Date in applicable federal statutes." Banks contemplating participating in the CPP have been so concerned about the potential negative ramifications of this provision, that the American Association of Bank Directors sent a [letter](#) to Secretary Paulson on November 3, 2008 lobbying for its deletion.

Notwithstanding concerns over the breadth of Section 5.3, the nation's largest banking organizations – already heavily regulated – have accepted it as part of the current CPP. We would expect that any private sector investor would be far more reluctant to participate in an investment which affords the government such broad discretion. Whereas the interests of banking institutions and the Treasury Department are largely aligned, the government does not have a similar stake in the safety and soundness of private sector investors. Such investors may be rightly concerned that political exigencies and increasing financial distress could lead Treasury to protect its (and the taxpayer's) investment first and foremost. Accordingly, any new CPP may involve modification of Section 5.3 as well as the addition of arrangements with Treasury for the protection of co-investors as would be customary among private parties.

This situation will continue to evolve, likely fairly rapidly, and we will continue to monitor and report on new developments. A comprehensive analysis of considerations when banks accept CPP funds can be found [here](#).

If you have any questions about the issues raised in this alert, please contact your usual Goodwin Procter attorney or any of the attorneys listed below:

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