Financial Services Alert

Comerica Announces Redemption of Trust Preferred Securities – Underscores Need for BHCs to Focus on Capital in Light of Collins Amendment

On September 1, 2010, Comerica Incorporated announced that its subsidiary Comerica Capital Trust II intends to fully redeem all $500 million of its 6.576% trust preferred securities (TPS). This announcement illustrates the need for bank holding companies (BHCs) to focus on long-term capital planning in light of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act). A section of the Act, commonly referred to as the Collins Amendment[1], mandates significant changes to existing risk-based capital requirements, one primary effect of which is to exclude TPS from the consolidated Tier 1 capital of most BHCs. Institutions with complex capital structures are likely to find that adequate planning will be complicated and require significant strategic analysis.

The first two parts of this Alert briefly summarize relevant provisions of the Collins Amendment. The third part identifies a number of practical considerations regarding its impact.

I. <u>Brief Summary</u>

The Collins Amendment requires appropriate Federal banking agencies to establish minimum risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies and nonbank financial companies supervised by the Federal Reserve. These minimum requirements must at least equal the risk-based capital requirements applicable to insured depository institutions under the prompt corrective action regulations (PCA regulations) implementing section 38 of the Federal Deposit Insurance Act. The PCA regulations are a separate and more stringent set of capital requirements than those capital requirements that have historically applied to BHCs. In particular, the PCA regulations do not include certain types of instruments, including TPS, as a component of Tier 1 capital. As such, the Collins Amendment will effectively eliminate TPS as an element of a BHC's consolidated Tier 1 capital. The Collins Amendment also sets forth minimum leverage capital requirements that must be no less than the quantitative requirements in effect for insured depository institutions under applicable PCA regulations.

[1] These provisions are set forth in Title I, Section 171 of the Act and were originally introduced by Senator Susan Collins (R-ME), with support from the FDIC, and further revised by the House-Senate Conference Committee as part of the financial reform reconciliation process. While the Act in its current form covers a variety of areas related to capital (including leverage requirements, application to nonbank financial companies, counter-cyclical capital requirements and various Government Accountability Office studies regarding treatment of capital and access to credit), the focus of this Alert is limited to the specific implications of the risk-based capital requirements described in the Collins Amendment.

II. Effective Dates, Phase-in Periods and Exemptions

The Act requires Federal banking regulators to promulgate regulations implementing the minimum risk-based capital requirements by January 2012. TPS issued after May 19, 2010 will not qualify as Tier 1 capital, except for BHCs with less than $500 million in assets or any Federal home loan bank. Securities issued to the United States pursuant to the Emergency Economic Stabilization Act of 2008 (e.g., securities issued under the TARP Capital Purchase Program) are also not subject to the Collins Amendment. The new risk-based capital requirements will be phased in over time. While the precise mechanics for phase-in remain unclear, the effective dates, phase-in periods and exemptions for treatment of TPS issued before May 19, 2010 are identified below.

Type of Institution	Phase-in / Effective Dates / Exemptions for TPS Issued Before May 19, 2010
BHCs with greater than $15 billion in assets (as of December 31, 2009) Nonbank financial companies supervised by the Federal Reserve	Exclusion of TPS from Tier 1 phased in incrementally over 3 years, beginning January 1, 2013 for TPS issued before May 19, 2010
BHCs with less than $15 billion in assets (as of December 31, 2009) Mutual holding companies (as of May 19, 2010)	No phase-in; TPS issued before May 19, 2010 are not subject to exclusion from Tier 1
Depository institution holding companies not supervised by the Federal Reserve (as of May 19, 2010)	No phase-in; exclusion from Tier 1 shall become effective by July 2015
BHC subsidiaries of foreign banking organizations (that rely on SR-01-1)	No phase-in; exclusion from Tier 1 shall become effective by July 2015
Federal home loan banks	No restrictions on TPS being included in Tier 1; not subject to Collins Amendment
Small BHCs, less than $500 million in assets	No restrictions on TPS being included in Tier 1; not subject to Collins Amendment

III. Practical Observations

While the operative provisions of the Collins Amendment remain subject to rulemaking, the phased-in elimination of TPS as a component of Tier 1 capital will have a significant impact on BHCs. Some practical observations BHCs may wish to consider as part of any preliminary analysis include:

- *Evaluate alternatives for early redemption of existing TPS.* Most TPS provide for a 5-year "no-call" period, during which time the TPS may not be redeemed. Of course, if the no-call period expires prior to the commencement of the phase-in period, optional redemption may be considered. It is worth noting that the terms of some institutional TPS issuances may require a "make-whole" premium payment upon early redemption, unless redemption occurs pursuant to a special exception, such as a regulatory capital event, described below. As such, certain issuers may be incented to redeem pursuant to a regulatory capital event rather than pursuant to a basic call provision.

  If the no-call period has not expired, the issuer will generally need to fall within an exception in order to redeem TPS. One common exception to the no-call provision is the occurrence of a "regulatory capital event," which generally occurs if, in the issuer's reasonable discretion, a change in law or related regulations occurs and "presents more than an insubstantial risk of impairment of the issuer's ability to treat the TPS as Tier 1 capital."

  BHCs should carefully analyze their TPS documentation to determine whether and/or when a "regulatory capital event" may be deemed to occur for one or more classes of TPS. One key part of this analysis should include whether there may be time limits on exercising any such redemption rights (usually 90 days from the occurrence of the event) and whether a "regulatory capital event" has been triggered upon the enactment of the Act or at some time in the future (e.g., adoption of the regulations or implementation of the phase-out period described above).

- *Redemption will require Federal Reserve approval and possible US Treasury (UST) approval for TARP issuers.* Any redemption of TPS, whether subject to a "regulatory capital event" call or any voluntary call permitted under applicable TPS documentation, will require prior approval by the Federal Reserve. In addition, approval by the UST may also be required to redeem existing TPS for those issuers who have issued securities to the UST as part of the TARP Capital Purchase Program. Such approval may be conditioned on raising additional equity capital before any TPS redemption is permitted.

- *Consider effects of replacement capital covenants on early redemption*. For those BHCs that have issued enhanced TPS that are subject to a replacement capital covenant (RCC)[2], consideration should be given to whether qualifying equity capital can be or has recently been raised. RCCs generally allow redemption of enhanced TPS only out of the proceeds of equity issued within 180 days of the redemption date.

- *Consider cost of alternative sources of Tier 1 capital, timing and funding strategies*. It is important to note that prior to phase-in of the exclusion from Tier 1, TPS are likely the most cost effective form of Tier 1 capital. Accordingly, issuers may in some instances wish to maintain existing TPS for as long as possible. Conversely, BHCs will need to evaluate, in consultation with their financial advisors, relevant market and timing considerations associated with issuing any new equity instruments in connection with TPS redemption, as issuing equity securities in a crowded market may result in less than optimal pricing.

- *Consider exchange offers as a possible structure alternative*. Conducting an exchange offer for one or more existing classes of TPS, especially if the TPS trade at a discount to par, can serve as a useful tool to preserve Tier 1 capital ratios by offering to exchange another form of equity capital for existing TPS. In the recent past, we have helped a number of BHCs successfully use exchange offers to reduce overall TPS issuances in other contexts. This may also be a viable option for those BHCs subject to the Collins Amendment provisions.

- *Consider growth in retained earnings as a viable capital alternative*. Some BHCs may find it is possible to "earn their way out" of potential decreases in Tier 1 capital ratios through increased retained earnings, thereby providing an issuer with more flexibility to redeem TPS (or allow TPS to remain outstanding and treated as Tier 2 capital after phase-in) without having to issue additional equity securities. As a general matter, the Federal Reserve may, in some cases, require issuers to at least partially redeem TPS with the proceeds of the issuance of another form of Tier 1 capital.

- *Implementation may be subject to further guidance by appropriate regulators*. Any potential capital planning with respect to Tier 1 capital levels should occur in consultation with appropriate regulators, as well as in light of the final implementing regulations, as specifics with respect to the new risk-based capital requirements remain to be finalized. In addition to the capital requirements set

[2] An RCC is a covenant issued by a BHC, for the benefit of certain other covered-debt holders, not to redeem the TPS except out of the proceeds of a new issuance of securities that generally contain the same or more equity-like characteristics. The specific terms of RCCs are highly technical, and require careful evaluation in each particular circumstance.

forth in the Collins Amendment, regulatory capital policy is likely to be further amended upon implementation of the Basel III Accord, which will be the subject of a future Squire Sanders Alert.

IV. Conclusion

Ultimately, the decision of whether, when and how to effect a redemption of TPS may be subject to many variables, which issuers should carefully consider in consultation with appropriate legal, tax, accounting and financial advisors. For example, the Comerica announcement states that its TPS redemption would occur at par, presumably in reliance upon the regulatory capital event exception allowing for an early call. Absent such exception, Comerica's TPS would require the payment of a make-whole premium in connection with redemption. It also appears that such redemption falls within a 180-day window from the date of Comerica's last equity offering, which presumably allows Comerica to satisfy the requirements of its RCC without issuing additional equity securities.

For further information regarding the impact of the Collins Amendment or financial reform generally, please contact your principal Squire Sanders lawyer or one of the individuals listed in this Alert.

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