SYNTHETIC EQUITY

IT'S THE REAL THING

OUR FINANCIAL INSTITUTION CLIENT had to get answers to several questions. As a participant in the U.S. government's Troubled Asset Relief Program (TARP), it was interested in determining the best way, or combination of ways, to raise Tier 1 capital in order to repay the TARP. Moreover, it sought to issue a security that would "count" as tangible common equity. If it were not able to meet these objectives, it was unlikely to receive approval to repay the government funds. The obvious answer might have been to issue and offer common stock. But there was a hitch. So, the follow-up question was how to raise Tier 1 and tangible common equity levels if the institution did not have sufficient authorized common stock. Of course, the objective was to complete the financing within a short period of time—shorter than the requisite time required to convene a shareholders' meeting to seek approval for additional authorized stock. The answer came in the form of a common stock equivalent.

The institution offered a security that functioned like common stock. This security effectively served as a placeholder until stockholder approval could be obtained following completion of the financing. Given that a common equivalent is a tailor-made security, its terms may be varied to suit the needs of the issuer. It's important to ensure that for applicable state law purposes, the synthetic common stock would not be considered an unauthorized class of preferred stock. In this case, the common equivalent was a bundled security comprised of a mandatorily convertible preferred stock, which automatically became common stock upon receipt of stockholder approval and otherwise became convertible into a fixed number of shares of common stock, and in-the-money contingent warrants that became exercisable only under limited circumstances. A synthetic security that provided a real solution.