



## Time To Retire Trust Preferred Securities

Posted by Edward D. Herlihy, Wachtell, Lipton, Rosen & Katz, on Wednesday July 4, 2012

**Editor's Note:** [Edward Herlihy](#) is a partner and co-chairman of the Executive Committee at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum.

Recently, the Federal Reserve Board issued a Notice of Proposed Rulemaking (NPR) to implement new capital rules consistent with Basel III, including the Collins Amendment requirement to phase out Tier 1 capital treatment of trust preferred securities (TruPS) for larger institutions. The NPR provides an opportunity for financial institutions to redeem at par many series of expensive TruPS that otherwise remain subject to “make whole” premiums on redemption.

As discussed in our prior memoranda ([January 2012](#) and [July 2010](#)), since Dodd-Frank, financial institutions facing loss of Tier 1 treatment for TruPS have been considering redemption and other means of reducing outstanding TruPS, which carry relatively high interest rates. One obstacle is that TruPS typically require a “make whole premium” above par to redeem in the initial years after issuance. But most TruPS also provide a special redemption right triggered by a “regulatory capital event.” This typically means a company’s reasonable determination that a change, or proposed change, in law or regulation causes a “more than insubstantial risk” of impairment of the issuer’s ability to include the TruPS in Tier 1 capital. There is sometimes a finite window for the redemption call following the event, e.g. 90 days.

In the wake of the NPR, a number of major financial institutions have taken steps to call TruPS. We anticipate others will follow. With TruPS sometimes yielding 6%-7% or more, the opportunity to redeem with cash earning 25 bps is an attractive strategy. Only a few institutions took advantage of the call right in the immediate wake of the Collins Amendment. Since then, however, some institutions have undertaken creative options to replace TruPS securities with less expensive forms of capital, including exchange offers, and others have called TruPS at par-plus redemption prices. In addition to issuance of the NPR, the issuance of final rules and the effective date of the loss of Tier 1 treatment may also be deemed “regulatory capital events” under the indenture language and create future windows to redeem at par.

Redemption requires coordination with regulators, including as to existing capital plans, as well as thoughtful consideration of the indenture language and any “replacement capital covenants” entered into in connection with a TruPS issuance. Issuers should bear in mind corporate and securities law issues, including disclosure obligations. Because of TruPS’ relatively generous yield in today’s environment, redemptions could attract legal challenges. However, a federal district court recently dismissed on the merits such a putative holder class action brought under New York Law against Wells Fargo.