

Financial Institutions Client Service Group

To: Our Clients and Friends

September 24, 2009

FDIC Issues Final Statement of Policy on Investor Qualifications for Failed Bank Acquisitions

Background

On July 2, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (“FDIC”) issued for public comment a proposed Statement of Policy that sets forth the qualifications for private equity investors in failed bank acquisitions (the “Proposed Policy”). The FDIC established a 30-day comment period and sought public comment on nine topics:

- definition of private equity investor and scope of the policy;
- permissibility of “silo” structures;
- capital requirements;
- applicability of the source of strength doctrine;
- imposition of cross-guarantee liability;
- restrictions on bidders from bank secrecy jurisdictions;
- post-investment holding period;
- possible limitations on 10% investors in failed institutions; and
- length of restriction period.

On August 26, 2009, the FDIC issued its Final Statement of Policy on Qualifications for Failed Bank Acquisitions (the “Final Policy”).¹ In response to 61 comment letters from a broad variety of interests, in the Final Policy the FDIC reduced the proposed capital requirements, removed the proposed “source of strength” requirement, and increased the ownership threshold for cross-guarantee liability. These changes are intended to make the failed bank acquisition opportunity more attractive

¹ The FDIC notes that the policy statement is just that—a statement of policy and not a statutory provision imposing civil or criminal penalties and that the requirements it imposes on investors only apply to investors that agree to its terms.

for private equity investors, while retaining many of the other elements of the Proposed Policy that address the FDIC's apparent concerns about such investors.²

Applicability and Scope

The restrictions set forth in the Final Policy apply to the following (referred to herein as "Covered Investors"):

- private investors in a company, including any company acquired to facilitate bidding on failed banks or thrifts, that is proposing to assume deposit liabilities and/or acquire assets from a failed depository institution;³ and
- applicants for insurance in the case of *de novo* charters issued in connection with the resolution of failed insured depository institutions.

The Final Policy does not apply to:

- an investor, following approval by the FDIC, in an existing financial institution or bank or thrift holding company, provided the financial institution subsidiary has maintained a composite CAMELS 1 or 2 rating continuously for seven years;
- investors in partnerships or similar ventures with an existing bank or thrift holding company where the existing holding company has a strong majority interest in the acquired bank or thrift and an established record for successful operation of insured banks or thrifts;⁴ or
- investors with 5% or less of the total voting power of the institution, as long as the investor is not acting in concert with one or more other investors.

Investment Requirements

The FDIC will apply the following requirements to Covered Investors:

Capital Commitment. A Covered Investor will be required to initially capitalize the acquiring entity at a minimum Tier 1 common equity to average assets ratio of 10% and maintain that

² The Final Policy is relevant only to bidders for failed financial institutions. Investors seeking to acquire control of banks that have not failed should refer to the Bank Holding Company Act and the relevant regulations and policy statements issued by the Federal Reserve Board including, but not limited to, the policy statement issued by the Federal Reserve Board on September 22, 2008 that eased certain limitations on private equity investments in banks and bank holding companies. This policy statement is summarized at <http://www.bankbryancave.com/wp-content/uploads/2008/10/private-equity.pdf>. Investors seeking to acquire control of federal savings institutions that have not failed should refer to the Home Owners' Loan Act and relevant regulations issued by the Office of Thrift Supervision. These existing holding company statutes and regulations are not replaced or substituted by the Final Policy. The Final Policy merely adds additional limitations and requirements in the context of acquiring failed financial institutions.

³ "Shelf charter" entities are specifically referenced in the Final Policy. "Inflatable" banks—healthy banks acquired with the intent to acquire the assets of other banks—presumably would be covered as well.

⁴ Such partnerships or similar ventures between private equity investors and existing holding companies are "strongly encouraged."

capital ratio for a period of three years from the time of acquisition. The FDIC may increase the required capital to a level higher than 10% in certain situations. Investors must maintain the bank at “well capitalized” levels for the remaining period of their ownership. Failure to satisfy these requirements will result in the institution being treated as “undercapitalized” for purposes of the prompt corrective action provisions, which would trigger a number of significant restrictions on operations.

Source of Strength. The Final Policy eliminated the proposed requirement that a Covered Investor’s organizational structure be expected to serve as a source of strength for its subsidiary depository institutions.

Holding Period. Covered Investors are prohibited from selling or otherwise transferring their interests in the subject holding company or depository institution for a three-year period, without FDIC approval.

Cross-Guarantee Liability. Covered Investors whose investments constitute 80% percent or more of more than one depository institution will be expected to pledge to the FDIC their interests in each such institution to pay for any losses to the deposit insurance fund that result from the failure of, or assistance provided to, any other such depository institution.

Affiliate Transactions. All extensions of credit by the acquired depository institution to its Covered Investors and their affiliates are prohibited. For purposes of the Final Policy, an “affiliate” is any company in which an investor owns 10% or more of the equity of that company for at least 30 days. Most existing extensions of credit are grandfathered.

Covered Investors Utilizing Bank Secrecy Jurisdictions. Covered Investors utilizing investment vehicles domiciled in bank secrecy jurisdictions⁵ are ineligible to own a direct or indirect interest in an insured depository institution unless the Covered Investors are subsidiaries of companies that are subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board and agree to certain information sharing arrangements.

Bidder Limitations on Existing 10% Owners. Covered Investors who held 10% or more of the equity or debt of a bank or thrift that goes through receivership are not be eligible to bid on that institution through the failed bank resolution process.

Silo Structures. Ownership structures in which the beneficial ownership is difficult to ascertain with certainty, the decision-making parties are not clearly identifiable, and ownership and control are separated, are prohibited. This would likely apply to any private equity “silo” ownership structure, where a private equity firm or its sponsor creates multiple investment vehicles funded and apparently controlled by the firm to acquire ownership of an insured depository institution. The FDIC is concerned that the purpose of such structures is to artificially separate the non-financial activities of the firm from its banking activities and allow the firm to avoid registration as a holding company.

⁵ A bank secrecy jurisdiction is a country that applies a bank secrecy law that limits bank regulators from determining compliance with U.S. laws or prevents the regulators from obtaining information or otherwise does not provide for the exchange of information with U.S. regulatory authorities.

Disclosure. Covered Investors will be expected to submit to the FDIC information about the investing entity and all entities in its ownership chain, including the size of the capital fund or funds, its diversification, return profile, marketing documents, management team and business model. Confidential treatment is available.

On a case-by-case basis, the FDIC may waive provisions of the Final Policy and has indicated that it will revisit the Final Policy in early 2010 to assess whether the rules are deterring investment or if other features need to be altered.

Conclusion

The substantive changes from the Proposed Policy to the Final Policy indicate some desire on the part of the FDIC to attract traditional private equity investors to participate in the failed bank resolution process. However, the Final Policy continues to reflect the FDIC's concern that private equity investors in failed financial institutions present unique supervisory risks, warranting additional restrictions on such investors.

Bryan Cave's Private Equity and Financial Institution groups have extensive experience in advising private equity firms and banking organizations in change of control transactions involving bank holding companies, banks, and thrifts.



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