Schulte Roth & Zabel

Alert

FDIC Releases Final Policy Statement on Acquisitions and Investments in Failed Banks or Thrifts by Private Capital Investors

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On August 26, 2009 the FDIC board of directors (the "FDIC Board") adopted the Final Statement of Policy on Qualifications for Failed Bank Acquisitions (the "Final Statement"). The purpose of the Final Statement is to provide guidance to private capital investors interested in acquiring or investing in failed insured banks or thrifts (collectively referred to herein as "banks") regarding the terms and conditions for such investments or acquisitions. In response to public comments, the Final Statement makes key changes to the following provisions of the FDIC's Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions (the "Proposed Statement"),[1] as well as other limited revisions described in more detail below: (1) applicability of the provisions of the Final Statement, (2) capital commitment, (3) cross support obligation, and (4) source of strength. The Final Statement does not affect any of the existing requirements under federal banking law (including the requirement that any investor acquiring 25% or greater voting interest in a bank must register as a bank holding company). The FDIC Board will review the operation and impact of the Final Statement within 6 months from August 26, 2009 and will make adjustments as it deems necessary. Below please find a summary of the provisions of the Final Statement.

Applicability of the Final Statement

The Final Statement will be applied prospectively from August 26, 2009 to private investors that make FDIC-assisted acquisitions of failed banks and to applicants for insurance in the case of *de novo* charters issued in connection with the resolution of failed banks ("Investors"). If the acquired bank maintains a CAMELS 1 or 2 rating continuously for seven years, the bank may apply to the FDIC to request for the provisions of the Final Statement to no longer apply to the Investors of the bank.

The Final Statement will not apply to Investors in partnerships or similar ventures with bank or thrift holding companies (excluding shell holding companies) where the latter have a "strong majority interest" in the acquired bank and an established record for successful operation of insured banks. The Final Statement encourages private equity to enter into such partnerships when participating in the bid process to acquire a failed bank. The Final Statement will also not apply to Investors who acquire 5% or less of the total voting power of a failed bank or its holding company provided that there is no evidence of concerted action by Investors. The FDIC Board may waive one or more provisions of the Final Statement if such exemption is in the best interest of the Deposit Insurance Fund ("DIF") and the goals and objectives of the Final Statement can be accomplished by other means.

[1] "FDIC Proposes New Tougher Qualifications for Failed Bank/Thrift Acquisitions by Private Capital Investors," *SRZ Alert*, July 2, 2009. Please click here for an overview of the FDIC's Proposed Statement.

Capital Commitment
The Final Statement revises the Proposed Statement's required capital commitment from a minimum 15% Tier 1 leverage ratio to a minimum 10% Tier 1 common equity ratio[2] for the first three years from the time of the acquisition. The FDIC, however, could require a minimum capital commitment above the 10% common equity ratio if warranted. Banks that acquire failed banks, by comparison, are generally only required to maintain a Tier 1 ratio of 5%. A bank's Tier 1 common equity is close to its tangible common equity, which is a stronger measure of capital than simple Tier 1 equity (*i.e.*, the ratio used for banks that acquire failed banks). For example, hybrid debt issuance that would qualify as capital under Tier 1 will not qualify under Tier 1 common equity. Following the initial three-year period, Investors must always maintain the bank at the "well capitalized" capital adequacy level (currently set at no less than 5% Tier 1 leverage ratio, 6% Tier 1 to risk-weighted assets, and 10% of total capital to risk-weighted assets) or be subject to Prompt Corrective Action ("PCA"). Once subject to PCA, the bank's regulator can require the bank to take various steps, such as selling securities or prohibiting the payment of subordinated debt, to restore the bank to a "well capitalized" level. In addition, the Final Statement eliminates the provision in the Proposed Statement that would have allowed the FDIC to extend the capital commitment requirement beyond the first three years from the time of the acquisition.

Source of Strength
The Final Statement eliminates the Proposed Statement's source of strength requirement, which would have required Investors to put up more capital if their banks faltered.

Cross Support Obligation
The Final Statement narrows the applicability of the cross-guarantee provisions (now referred to as "cross support") detailed in the Proposed Statement. Under the Final Statement, Investors who, individually or collectively, own 80% or more of two or more insured banks would be required to pledge to the FDIC their proportionate interests in each institution to pay for any losses to the DIF resulting from any commonly-owned institution. The FDIC may waive this provision if enforcing the obligation will not reduce the cost of the bank failure to the DIF.

Transactions with Affiliates
Limited changes were made to the scope of the affiliate transactions provision in the Final Statement. Generally, an insured bank acquired or controlled by Investors would be prohibited from extending credit to Investors, their investment funds, or an affiliate of either. The Final Statement adds an exemption for existing extensions of credit and modifies the definition of "affiliate" to mean "any company in which the Investor owns, directly or indirectly, at least 10% of the equity of such company and has maintained such ownership for at least 30 days." The FDIC indicated that the modified definition of "affiliate" is designed to make compliance easier and is based on the assumption that very short term investments do not provide a reason for extensions of credit. The Final Statement also requires Investors to provide regular reports to the bank identifying all affiliates.

Secrecy Law Jurisdictions
The Final Statement retains the prohibition on employing ownership structures utilizing entities that are domiciled in "bank secrecy jurisdictions" to acquire a direct or indirect interest in a failed bank. In addition, the Final Statement defines a "bank secrecy jurisdiction" as "a country that applies a bank secrecy law that limits U.S. bank regulators from determining compliance with U.S. laws or prevents them from obtaining information on the competence, experience and financial condition of applicants and related parties, lacks authorization for exchange of information with U.S. regulatory authorities, or does not provide for a minimum standard of transparency for financial activities."

Continuity of Ownership
The Final Statement retains the three-year holding period for failed bank acquisitions (*i.e.*, the provision that prohibits Investors from selling or transferring securities of the insured bank for three years following the acquisition without prior approval of the FDIC). In addition, the Final Statement adds a statement that in the case of transfers to affiliates FDIC approval will not be unreasonably withheld provided the affiliate agrees to

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[2] Tier 1 common equity is defined as Tier 1 capital minus non-common equity elements. Non-common equity elements are defined as qualifying perpetual preferred stock, plus minority interests and restricted core capital elements not already included.

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be subject to the same requirements that are applicable under the Final Statement to the transferring Investor. Furthermore, the FDIC clarified that the three-year holding period will not apply to mutual funds defined as open-end investment companies registered under the Investment Company Act of 1940 that issue redeemable securities that allow investors to redeem on demand.

Prohibited Structures

The FDIC received many public comments opposing the blanket prohibition of "silo" structures as acquisition vehicles, but ultimately retained the prohibition in the Final Statement. The Final Statement clarifies that the FDIC will not approve ownership structures that typically involve a private equity firm (or its sponsor) that create multiple investment vehicles funded and apparently controlled by the private equity firm (or its sponsor) to acquire ownership of an insured bank. The FDIC indicated that it is concerned that the purpose of these "silo" structures is to artificially separate the non-financial activities of the firm from its banking activities so that the private equity firm is not required to become a bank or thrift holding company.

Special Owner Bid Limitation

The Final Statement retains the special owner bid limitation of the Proposed Statement. Investors that, directly or indirectly, hold 10% or more of the equity of a bank in receivership will not be eligible to bid to acquire that bank or its deposit liabilities.

Disclosure

In response to commenters' concerns about confidentiality, the Final Statement provides that confidential business information will be treated as such and not disclosed except in accordance with applicable law. The Final Statement, otherwise, retains the disclosure requirements of the Proposed Statement. Investors will be expected to submit to the FDIC information about the Investors and all entities in the ownership chain including information regarding the size of the capital fund or funds, its diversification, the return profile, the marketing documents, the management team and the business model.

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