Schulte Roth&Zabel

Alert

FDIC Proposes New Tougher Qualifications for Failed Bank/Thrift Acquisitions By "Private Capital Investors"

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Today, the Federal Deposit Insurance Corporation ("FDIC") issued a proposed "Statement of Policy on Qualifications for Failed Bank Acquisitions" (the "Proposed Policy Statement") with a request for comments. The purpose of the Proposed Policy 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. (The Proposed Policy Statement does not purport to change the requirements for the acquisition of banks outside of receivership.) The proposed rules do not affect any of the existing requirements under federal banking law (including the requirement that any investor acquiring a 25% or greater voting interest in a bank must register as a bank holding company). Instead, the FDIC would impose significant new requirements on "private capital investors" that make FDIC-assisted acquisitions of failed banks ("Investors"). Such new requirements include capital support and cross-guarantee obligations, as well as new prohibitions on transactions with affiliates and "secrecy jurisdiction" investors that are not subject to comprehensive consolidated supervision.

Our initial observation is that the Proposed Policy Statement will make the process of acquiring failed banks more difficult and may make such acquisitions economically unattractive for Investors. Moreover, certain key concepts need further clarification. For example, the term "private capital investor" is not defined. Furthermore, while the Proposed Policy Statement clearly targets "club deals" and other acquisition structures comprised entirely of private investment funds, it is not entirely clear whether, or how, these proposed rules would apply to situations where such funds represent only part of the total investor group.

Interested parties will have 30 days from the date on which the Proposed Policy Statement is published in the Federal Register to submit written comments to the FDIC. Moreover, the FDIC indicated that they will be holding a roundtable discussion on July 6, 2009. Accordingly, changes or clarification should be forthcoming. Of particular note, two of the FDIC's five Board members have already voiced their opposition to the Proposed Policy Statement as currently drafted. We will provide updates to our clients as the proposal develops.

Below is a brief summary of the main issues addressed by the Proposed Policy Statement. A complete copy of the Proposed Policy Statement, as well as instructions on how to submit comments to the FDIC, is available here. (Please contact us if you would like assistance in commenting on the Proposed Policy Statement.)

Capital Commitment
Investors will be required to capitalize the bank at a minimum 15% Tier 1 leverage ratio for a period of at least three years (as opposed to the 8% to 10% requirement typically imposed on new institutions). Thereafter, the 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).

Source of Strength
The bank holding company in which the Investors have invested will be expected to sell equity or borrow money to raise any additional capital needed by the bank. However, it does not appear to require the Investors to contribute any additional capital to the bank holding company. So, while their investment in the bank may be diluted, their other investments and assets would not appear to be exposed to the needs of the bank. However, one of the items on which the FDIC is specifically seeking comment is whether this source of strength commitment should be enhanced to require a broader obligation from the bank holding company and/or the Investors.

Cross-Guarantees
Investors who, individually or collectively, own a majority of more than one insured bank would be required to pledge to the FDIC their proportionate interests in each institution to pay for any losses to the deposit insurance fund resulting from any commonly-owned institution.

Continuity of Ownership
Without the prior approval of the FDIC, Investors would be prohibited from selling or otherwise transferring securities of the insured bank for 3 years following the acquisition. In order to obtain FDIC approval for such a transfer, the transferee would need to agree to be bound by the same terms (*i.e.*, those required under the Proposed Policy Statement) as the transferring Investor.

Transactions with Affiliates
An insured bank acquired or controlled by Investors would be prohibited from extending credit to Investors, their investment funds, any affiliates of either, and any of their portfolio companies. An "affiliate" is defined as "any company in which an investor owns 10 percent or more of the equity of that company." (It should be noted that the Proposed Policy Statement defines "portfolio companies" as companies in which the Investors or affiliates "invest." Therefore, as written, the rule would appear to cover all companies in which the Investors or affiliates invest not just those in which they hold a 10% or greater interest.)

Secrecy Law Jurisdictions
Investors "employing ownership structures utilizing entities that are domiciled in bank secrecy jurisdictions" would not be permitted to acquire a direct or indirect interest in a failed bank, unless the Investors are subsidiaries of companies that are subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board. In addition, such Investors must agree: (1) to provide the bank's primary federal regulator with certain disclosure; (2) maintain its books and records (or a duplicate) in the U.S.; (3) consent to jurisdiction and designation of an agent for service of process; and (4) consent to be bound by U.S. banking laws. Although the term "bank secrecy jurisdiction" is not defined, the term "secrecy jurisdiction" normally refers to a jurisdiction in which the local law prohibits on-site examination of an entity or the removal of books and records, or other information necessary for the adequate examination of such entity. It is unclear whether this restriction would apply to an Investor, such as a fund, that is domiciled in a bank secrecy jurisdiction that invests in an ownership structure that only utilizes entities domiciled in non-bank secrecy jurisdictions.

Special Owner Bid Limitation
Investors that, directly or indirectly, had held 10% or more of the equity of a bank at the time it was placed into receivership would not be eligible to be part of a bid to acquire the bank or its deposit liabilities.

Disclosure
Investors would 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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