MEMORANDUM TO: The Board of Directors

FROM: Sandra L. Thompson
Director
Division of Supervision and Consumer Protection

Michael Bradfield
General Counsel

SUBJECT: Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions

I. SUMMARY OF RECOMMENDATION

Staff recommends that the Board authorize publication of a proposed Statement of Policy on Qualifications for Failed Bank Acquisitions with a request for comments, as described in the attached Federal Register notice. This proposed policy statement would provide guidance to private capital investors interested in acquiring or investing in failed banks or thrifts regarding the terms and conditions for such investments or acquisitions.

II. BACKGROUND

Recently, private capital investors have indicated interest in purchasing insured depository institutions in receivership.[1] The FDIC is particularly concerned that owners of banks and thrifts, whether they are individuals, partnerships, limited liability companies, or corporations, have the experience, competence, and willingness to run the bank in a prudent manner, and accept the responsibility to support their banks when they face difficulties and protect them from insider transactions.

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[1] The purchase or acquisition of a failed depository institution in receivership refers to the purchase of the deposit liabilities, or both such liabilities and assets.

The FDIC has recently completed two resolution transactions involving new private capital investors. After the Office of Thrift Supervision's determination that each particular investor group met its eligibility requirements, the FDIC accepted the bids of two separate groups to acquire two failed savings and loan associations.[2] The bids of the investors were the least costly to the Deposit Insurance Fund (DIF) of all competing bids. Under the FDI Act, the FDIC has the responsibility to ensure that failing institutions are resolved in a manner that will result in the least cost to the DIF and minimal disruption to the financial system.[3]

Shortly after the second of the above transactions, the FDIC issued a May 21, 2009 press release stating that the FDIC would provide guidance concerning when prospective acquisitions comply with the requirements for granting and maintaining federal deposit insurance and for limiting risks to the DIF. In developing this proposed policy statement we looked carefully, in particular, at those provisions needed for the purpose of protecting the DIF, as well as the statutes and regulations aimed at assuring the safety and soundness of insured depository institutions, assuring support by the insured depository institution's holding company, and limiting the provision of credit by insured banks to affiliated parties.

[2] In March 2009, the FDIC completed the sale of the IndyMac Federal Bank, FSB, Pasadena, California, to One West Bank, FSB, a newly formed Federal savings bank controlled by IMB Management Holding LP, which was funded by a consortium of private equity investors that invested over $1 billion in the capital of the new thrift. In May 2009, the FDIC as receiver for BankUnited, FSB, Coral Gables, Florida, sold its banking operations to a newly chartered Federal savings bank owned by a group of private equity investors including W.L. Ross & Co. LLC, Carlyle Investment Management L.L.C., Blackstone Capital Partners V L.P., and Centerbridge Capital Partners, L.P. that invested $900 million in this thrift.

[3] 12 U.S.C. § 1823(c)(4).

III. DISCUSSION

How investments in insured depository institutions are structured can raise important considerations for the banking system and for the FDIC. The FDIC must carefully weigh the potential contribution that investors could make to strengthening the capital position of domestic banks and the statutory and regulatory framework aimed at maintaining well capitalized banks, support for these banks when they face difficulties, and protections against insider and affiliate transactions. The ability of the owners to support the depository institution with adequate capital and management expertise are essential safeguards.

Staff has reviewed various elements of private capital investment structures for consistency with the foregoing principles and considers that some of these investment structures would not be considered as appropriate for approval for ownership of insured depository institutions. These include structures involving complex and functionally opaque ownership structures, typified by the so-called "silo" organizational arrangements, in which the beneficial ownership cannot be ascertained, the responsible parties for making decisions are not clearly identified, and/or ownership and control are separated. Other ownership structures raise important policy issues with respect to their compliance with the requirements applied by the FDIC in its decision on the granting of deposit insurance. The concerns center on the need for fully adequate capital, a source of financial and managerial strength for the depository institution, and the potential adverse effects of extensions of credit to affiliates.

To address the concerns raised mainly by ownership structures involving more than *de minimis* investments that typically involve a shell holding company owned by another entity or other entities that avoid certain of the responsibilities of bank and thrift ownership, the FDIC is establishing standards for bidder eligibility that would be applicable to (a) private capital investors in a company (other than a bank or thrift holding company that has come into existence or has been acquired by an Investor at least 3 years prior to the effective date of the final policy statement), that is proposing to directly or indirectly assume deposit liabilities, or such liabilities and assets, from a failed insured depository institution in receivership, and to (b) applicants for insurance in the case of de novo charters issued in connection with the resolution of failed insured depository institutions (hereinafter "Investors"). The proposed policy statement provides guidance on how the FDIC would apply these standards to Investors as discussed below.

Pursuant to the proposed policy statement, the Investors' holding company will be expected to provide for the capital support of the acquired or de novo depository institution through a strong initial capital contribution – maintaining a minimum 15 percent Tier 1 leverage ratio for a period of at least 3 years. Staff believes that up-front capital protection for the depository institution would provide an effective cushion that could have a lasting impact. Thereafter, Investors will be expected to cause the depository institution to maintain sufficient capital such that it will be at a level no lower than "well capitalized" during their ownership. Investors will also be expected to provide a contractual cross guarantee over substantially common owned depository institutions. There is also an expectation that Investors' insured depository institutions will not extend

credit to Investors, their investment funds, affiliates, or portfolio companies. Staff believes that a strong prohibition on lending to these entities is important given the absence of the limitations on non-banking activities of private capital investors that are applicable to bank and thrift holding companies. Additionally, Investors will be expected to maintain the continuity of ownership through a prohibition on the sale or transfer of their interest in the acquired or de novo insured depository institution or its parent holding company for a three year period absent the FDIC's consent. This measure is designed to ensure that Investors are committed to providing banking services to the community served by the acquired institution and provide a continued link with the parties with which the FDIC has entered into a loss sharing agreement. A special limitation provides that Investors holding 10 percent of more of the equity of a bank or thrift in receivership would not be considered eligible to bid to become an investor in that failed institution. Finally, Investors will be expected to avoid secrecy law jurisdiction vehicles as the channel for their investments unless the parent company is subject to consolidated home country supervision, and to submit to the FDIC information about all entities in the ownership chain, among other disclosures.

Nothing in this proposed policy statement is intended to relieve Investors of any requirements imposed by the appropriate Federal banking agency for a relevant depository institution or bank or thrift holding company under any applicable regulation or statute, including, in particular, holding company statutes and rules. In addition, nothing in this proposed policy statement is intended to effect supervisory determinations made with respect to the general character and fitness of the management being proposed

by the Investors and the need for a thorough and reasonable business plan that addresses business lines and strategic initiatives and includes appropriate contingency planning elements, satisfactory corporate governance structure and representation, or any other supervisory determinations.

The proposed policy statement is being published with a request for comment in order to provide the FDIC to the benefits of public input before the policy statement becomes effective. Comment is invited on all aspects of the proposed policy statement for a period of 30 days. In addition there are eight specific questions soliciting comment in areas, including the following: should these measures apply to the types of investors defined in the proposed policy statement or some other or more limited types of investors; should investors proposing so-called "silo" structures be considered as eligible bidders; what level of capital is appropriate to ensure that acquired depository institutions have sufficient capital; and should the Source of Strength commitment be enhanced.

IV. CONCLUSION

For the reasons discussed above, staff recommends that the Board authorize publication of the proposed policy statement in the Federal Register with 30-day comment period.