



## FDIC Statement of Policy on Qualifications for Failed Bank Acquisitions Creates Significant Hurdles for Private Investors

### I. Introduction and Background

On Aug. 26, 2009, the FDIC issued in final its Statement of Policy on Qualifications for Failed Bank Acquisitions (the “Policy Statement”). The Policy Statement describes the terms and conditions the FDIC expects private capital investors to satisfy in order to be eligible to invest in failed banks and *de novo* banks formed to acquire deposits of failed banks. As discussed below, these measures address capital support and cross-guarantees, transactions with affiliates, secrecy jurisdiction investors, continuity of ownership requirements, and disclosure of investor information to the FDIC. The standards supplement, and do not supplant in any way, applicable bank or thrift statutes, regulations, and determinations. Accordingly, for example, the Policy Statement does not affect the substantial issues related to “control” under the Bank Holding Company Act administered by the Federal Reserve Board or comparable thrift control issues administered by the Office of Thrift Supervision, both of which have a significant effect on structuring private equity investments in banking organizations.

After issuing a proposed policy statement on July 2, 2009 (the “Proposal”), the FDIC adopted the Policy Statement with only minor changes from the Proposal. The principal change was to reduce the minimum leverage ratio of the acquired bank for the first three years from 15 percent to 10 percent. The Policy Statement also eliminated a proposed “Source of Strength” requirement that would have required an investor holding company to serve as a source of capital for a depository institution in certain circumstances.

### II. The Policy Statement

#### A. Scope: Who Is a Covered “Investor”?

The Policy Statement largely adopts the scope of the Proposal, but adds an additional exemption for investments made by private equity interests in existing healthy banks or in *de novo* institutions that are not formed for the purpose of acquiring a failed bank or the deposits of a failed bank.

The Policy Statement applies prospectively to:

- (i) private capital investors in certain companies that are proposing to assume deposit liabilities, or both liabilities and assets, from a failed insured depository institution in receivership (including all entities in such an ownership chain); and
- (ii) applicants for insurance in the case of *de novo* charters issued in connection with the resolution of failed insured depository institutions. ((i) and (ii) collectively, “Investors”).

The Policy Statement will not apply to existing banking organizations or to Investors holding 5 percent or less of the total voting power of an acquired banking organization. The Policy Statement

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will continue to apply to an Investor until the acquired bank has maintained a CAMELS composite rating of 1 or 2 continuously for seven years, and received FDIC approval.

In addition, the FDIC added a catch-all provision which states that the agency may waive any of the provisions of the Policy Statement if it is in the best interests of the Deposit Insurance Fund and the goals and objectives of the Policy Statement can be accomplished by other means.

## B. The Standards: What Will Be Required?

The final Policy Statement imposes onerous conditions on potential nonbank acquirers of deposits in failed banks. The conditions fall into eight general categories. The combined effects of the conditions are to limit the flexibility in structuring ownership groups, limit achieving an acceptable rate of return, and impose a heavy ongoing regulatory burden on any potential Investor. These conditions would generally not apply in the same manner to a private equity investor that purchases an ownership interest in a bank or thrift.

### 1. Capital Commitment

A failed bank or *de novo* shelf-charter bank acquired by an Investor group would be required to maintain a common equity leverage ratio (Tier 1 capital excluding non-common stock elements to total assets) of at least 10 percent for a minimum of three years after acquisition. The FDIC had originally proposed a Tier 1 leverage ratio requirement of 15 percent. After three years, the depository institution must remain at least “well capitalized” so long as an Investor remains an owner of the bank. If the institution fails to meet these requirements at any time, it will be treated as “undercapitalized” for purposes of Prompt Corrective Action and any required measures under those rules.

### 2. Cross-Support

If one or more Investors own 80 percent or more of two or more banks or thrifts, then the stock commonly owned by the Investor(s) must be pledged to the FDIC. In the event any commonly-owned bank fails, the FDIC may exercise the pledged stock to the extent necessary to recoup the relevant losses incurred. The FDIC modified this requirement from the Proposal to implement the 80 percent threshold.

### 3. Transactions with Affiliates

The Policy Statement prohibits extensions of credit from acquired depository institutions to Investors, their investment funds, if any, and any affiliates of either. Extensions of credit existing at the time of the acquisition are not affected. An affiliate is defined as “any company in which the Investor owns, directly or indirectly, at least 10 percent of the equity of such company and has maintained such ownership for at least 30 days.” In order to facilitate compliance with this requirement, an Investor must provide regular reports to any relevant depository institution identifying all of its affiliates.

### 4. Secrecy Law Jurisdictions

The Policy Statement excludes from eligibility an Investor with any entities domiciled in “secrecy law jurisdictions,”<sup>1</sup> unless the Investor (i) is a subsidiary of a company that is subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board; and (ii) with respect to its foreign entities, (a) agrees to provide information to the primary federal regulator about its non-domestic operations and activities; (b) maintains its business books and records (or a duplicate set) in the United States; (c) consents to the disclosure of information that might be covered by confidentiality or privacy laws and agree to cooperate with the FDIC, if necessary, in obtaining information maintained by foreign government entities; (d) consents to jurisdiction and designation of an agent for service of process; and (e) consents to be bound by the statutes and regulations administered by the appropriate U.S. federal banking agencies.

### 5. Continuity of Ownership

Under the Policy Statement, an Investor is prohibited from selling or otherwise transferring securities of the Investor’s holding company or depository institution for three years following the acquisition absent the prior approval of the FDIC. The FDIC will not unreasonably withhold approval in the case of an affiliate transfer, provided the affiliate agrees to the same terms and conditions to which the initial Investor was subject. The Policy Statement excepts from this requirement any mutual fund defined as an open-ended investment company registered under the Investment Company Act of 1940 that issues redeemable securities that allow investors to redeem on demand.

### 6. Prohibited (or “Silo”) Structures

The FDIC continues to identify “complex and functionally opaque ownership structures in which the beneficial ownership is difficult to ascertain with certainty” as problematic. In particular, the

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<sup>1</sup> The Policy Statement defines “secrecy law 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, does not provide for a minimum standard of transparency for financial activities, or permits off shore companies to operate shell companies without substantial activities within the host country.”

FDIC states that the beneficial ownership and decision-making parties are difficult to identify, and ownership and control are separated. The FDIC had singled out so-called “silo” structures as ineligible bidders for failed bank assets and liabilities. The final Policy Statement does not expressly identify “silo funds,” but effectively precludes a silo fund structure in its description of disfavored ownership structures.

#### 7. Special Owner Bid Limitation

A person that holds, directly or indirectly, 10 percent or more of the equity of a bank or thrift in receivership, is not eligible to bid to become an Investor in that failed institution.

#### 8. Disclosure

An Investor is expected to submit substantial information disclosure across various categories to the FDIC, including information about its investors and all entities in its ownership

tree. This includes information regarding:

- (i) the size of the capital fund or funds;
- (ii) their diversification;
- (iii) their return profile(s);
- (iv) their marketing documents;
- (v) their management team(s); and
- (vi) their business model(s).

The Policy Statement includes an additional catch-all provision that would require disclosure of “such other information as is determined to be necessary to assure compliance with [the Policy Statement].” Confidential business information that is submitted to the FDIC in accordance with this requirement will be maintained as confidential and not disclosed other than in accordance with law.

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The Financial Services Practice Group of Winston & Strawn represents a broad range of financial institutions and prospective investors in financial institutions on issues involving the acquisition ownership interests or control of a depository institution or assets of a failed depository institution. If you have any questions regarding the matters discussed in this briefing, please contact any of the Winston & Strawn attorneys listed below or your usual Winston & Strawn contact:

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