United States Senate
WASHINGTON, D.C. 20510

August 6, 2009

Sent via email to Comments@FDIC.gov

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

RE: RIN 3064-AD47: Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions

Dear Madame Chairman:

The purpose of this letter is to offer strong support for the proposed statement of policy issued by the Federal Deposit Insurance Corporation (FDIC) clarifying the qualifications that must be met by private capital investors wishing to acquire or invest in a failed United States bank or thrift. While supportive of the provisions as currently drafted, we also recommend strengthening the proposed policy statement related to secrecy law jurisdictions.

Stable and prosperous banks are key to a thriving U.S. economy. Banks provide the credit and financing that is the lifeblood of businesses, communities, and families. They offer critical financial services, such as money transfers, checking accounts, and credit cards, that enable modern society to function. They play a lynchpin role in the housing and real estate markets. They protect savings and retirement nest eggs.

When banks collapse, they disrupt the local economy, impose economic hardships on clients, hurt surrounding communities, and impair other financial institutions and businesses. In addition, a failed bank can undermine confidence in the U.S. financial system as a whole and even precipitate more failures and economic problems.

We have witnessed many bank and thrift failures, from the $150 billion savings & loan crisis during the 1980s, to the wave of bank failures during the early 1990s, to the thrift and bank failures over the last year associated with the current financial crisis. We have seen how those failures, despite government intervention, have disrupted communities and required hundreds of billions of dollars to resolve. This recent history amply demonstrates the importance of the precautions taken by the FDIC to ensure that those wishing to purchase a failed institution understand and accept the public trust involved in owning a U.S. bank or thrift, and have the means, expertise, and commitment needed to ensure a safe and sound banking institution.

Traditionally, banks and thrifts have been owned by holding companies whose investors have included individuals, corporations, and limited liability companies. In recent years,

however, additional classes of investors, such as private equity funds and hedge funds, have sought to acquire ownership interests in failed U.S. banks and thrifts. These prospective investors, referred to as "private capital investors" in the proposed guidance, have raised concerns due to perceptions that some may favor short-term investment returns over long-term commitments, and prefer secrecy to the transparency that has traditionally characterized bank ownership in the United States. To allay these concerns, provide notice of the expectations and standards related to U.S. bank ownership, and afford private capital investors the opportunity to acquire ownership interests in a failed U.S. bank or thrift on terms that protect the public, the FDIC has developed needed guidance on some of the qualifications required to become an owner of a failed U.S. insured depository institution.

The proposed guidance presents nine common-sense policies, derived from FDIC standard banking practice and experience, that must be adopted by private capital investors seeking to acquire or invest in a failed U.S. bank or thrift. All are important, but one in particular, regarding secrecy law jurisdictions, should be further strengthened.

Capital Commitment, Source of Strength, and Continuity of Ownership. First and most importantly, the proposed guidance makes it clear that those wishing to take ownership of a failed U.S. bank or thrift must stand ready to make a sustained commitment of capital over a period of years. The proposed policy statement on capital commitment makes it clear that investors must be willing to provide adequate capital at the time of acquisition to ensure an ongoing concern. The following source of strength policy statement makes it plain that, after providing an initial capital outlay, investors must be willing to raise additional capital or borrow funds if needed to ensure an institution's ongoing viability. The proposed policy on continuity of ownership would prohibit investors in a failed U.S. bank or thrift from selling their securities in the institution or its holding company for a minimum of three years, absent FDIC approval. Together, these three safeguards make it clear that acquiring a U.S. bank or thrift should not be viewed as a short-term investment opportunity to turn a quick profit, but must be treated as a long-term commitment requiring steady and significant investment over several years. Only investors willing to meet each of these commitments should be eligible to take ownership of a failed U.S. bank or thrift.

The proposed guidance requests comment on whether three years is the correct period of time to prohibit the sale of relevant securities after acquisition of a failed institution. From our perspective, three years is the minimal acceptable period and may even be too brief. Failed financial institutions typically require several years to regain their footing, and require dedicated funding and support during that period. Since it is not uncommon for private equity funds and hedge funds to make investment commitments of three to five years in other endeavors, this requirement is both reasonable and prudent. Any shorter period would invite investors with shorter time horizons, whose primary goal may be to turn a profit rather than contribute to a stable banking institution willing and able to provide the lending and financial services our communities need. A shorter time period might also encourage more rapid turnover in bank ownership, which would be an unhealthy and undesirable development.

Cross Guarantees. The proposed guidance also contains a policy statement that would require investors seeking to gain an ownership interest in more than one U.S. bank or thrift to pledge their proportionate interests in each such institution to pay for any FDIC insurance loss. This cross guarantee commitment is not only prudent, but would help ensure that private capital investors understand that it is not possible to game the system by segregating or hiding assets from the FDIC in the event of a bank or thrift failure.

Transactions with Affiliates. Next, the proposed guidance contains a policy statement making it clear that a bank or thrift owned by private capital investors may not offer any credit to those investors, their investment funds, investment companies, or affiliates. This prohibition reflects standard practice within the banking industry aimed at preventing insiders from taking advantage of the banks they own. It is a response to a sordid history of some bank insiders who have obtained large loans, failed to repay them, depleted bank capital, and contributed to a weakened bank. This prohibition on insider loans is an essential safeguard to make it clear to private capital investors that they cannot expect their ownership interest in a U.S. bank or thrift to translate into a financial institution available to provide loans to their affiliates.

Secrecy Law Jurisdictions. The next safeguard, which proposes restrictions related to secrecy law jurisdictions, is particularly significant. It is a response to the attempt of some private capital investors to use offshore structures in jurisdictions with secrecy laws to establish their ownership interests in a U.S. bank or thrift. Apparently, some private equity funds or hedge funds seeking to acquire a failed institution proposed cloaking their ownership interests behind offshore shell entities, making it difficult for the FDIC to determine the identity of the prospective owners. Some apparently even proposed setting up an offshore ownership structure with the intent, after acquisition of a failed institution, of quickly transferring or "flipping" that ownership to a new structure. Such efforts are a direct affront to U.S. traditions of transparent, stable, and prudent bank ownership.

There is simply no justification for the FDIC or any other U.S. regulator to allow a prospective owner of a U.S. bank or thrift to use an offshore ownership structure instead of an ownership structure established right here in the United States. Offshore structures, by their nature, are outside of U.S. regulatory control, invite disputes over secrecy laws and practices, and raise concerns about how to resolve conflicting laws between the United States and the offshore jurisdiction. Offshore structures also have a history of association with financial fraud, money laundering, tax evasion, and other misconduct and, due to secrecy laws, have posed obstacles to investigative efforts by U.S. law enforcement and regulators.

In one investigation conducted by the U.S. Senate Permanent Subcommittee on Investigations, several hedge funds and private equity funds established by two U.S. citizens, Sam and Charles Wyly, used offshore structures to secretly funnel millions of dollars in offshore funds into the United States. The owners of those offshore funds were hidden behind layers of offshore corporations and trusts, and were difficult to identify. Subcommittee investigations have often found that offshore structures have been used to dodge payment of U.S. taxes,

including by hedge funds avoiding taxes owed on U.S. dividends and by nonprofit entities avoiding payment of unrelated business income taxes.

A policy allowing offshore owners of U.S. banks and thrifts would open the door to a wide range of transparency problems, questionable arrangements, and potential abuses, with no countervailing benefit to the United States. U.S. bank ownership has traditionally been founded on U.S. ownership structures; there is no reason to start moving U.S. bank ownership offshore and a multitude of reasons against allowing offshore arrangements that could undermine effective U.S. regulatory oversight and control of U.S. financial institutions.

The proposed policy statement, as currently worded, seeks to place a variety of conditions and restrictions on the use of offshore ownership structures, but fails to take the necessary step of simply prohibiting their use as an ownership vehicle for U.S. banks and thrifts. The statement should be strengthened to establish a clear policy against allowing offshore ownership structures for U.S. banks and thrifts. To establish this prohibition, the current policy statement could be reworded as follows: "Investors employing ownership structures utilizing entities that are domiciled in bank secrecy jurisdictions are not eligible to own a direct or indirect interest in an insured depository institution."

If the proposed policy statement does not establish a clear prohibition, it should at least be clarified. As currently drafted, the proposed provision would allow offshore ownership structures if the "Investors are subsidiaries of companies that are subject to comprehensive consolidated supervision ('CCS') as recognized by the Federal Reserve Board." It is not clear what subsidiaries would be covered by this language. Stand-alone private equity funds and hedge funds are not typically subject to comprehensive consolidated supervision, so presumably their subsidiaries would not be covered. On the other hand, the provision could perhaps be interpreted to allow offshore structures established by subsidiaries of hedge funds registered with the Securities and Exchange Commission under the Investment Advisers Act. Alternatively, the provision could be interpreted to allow only offshore structures set up by a subsidiary of a bank or broker-dealer. If that is the intent of the provision – to allow only those offshore structures owned by a subsidiary of a bank or broker-dealer already subject to U.S. regulation – that restriction needs to be spelled out. The question would remain, of course, why the guidance would allow a regulated entity to hold its ownership interest through an offshore structure rather than a structure formed right here in the United States. It should not, as urged above.

The remaining portion of the provision, as currently drafted, essentially tries to force an allowable offshore entity to keep its books and records in the United States, to accept service of process in the United States, to disclose information to U.S. regulators, to cooperate with FDIC information requests, and to consent to be bound by U.S. laws and regulations. Instead of creating this thicket of requirements to try to require an offshore entity to operate as if it were a U.S. entity, the more straightforward, sensible, and prudent approach would be to require prospective owners of U.S. banks and thrifts to use U.S. ownership structures in the first place.

Special Owner Bid Limitation. The next proposed policy statement is also important. It would make investors who directly or indirectly own 10 percent or more of a U.S. bank or thrift in receivership ineligible to seek ownership of that failed institution's liabilities or assets. This safeguard would remove any incentive for an existing bank or thrift owner to place the institution in receivership so that it could then bid on the failed institution's assets and liabilities. Since some private equity funds and hedge funds specialize in taking over failed businesses, dismantling their operations, and selling their assets and debt instruments, this precaution is necessary to inform private capital investors that such an approach is not permitted in the case of an insured depository institution.

Disclosure. The next policy statement in the proposed guidance states that private capital investors wishing to acquire or invest in a U.S. bank or thrift must be prepared to submit to the FDIC information about all entities in its ownership chain, the volume and nature of its assets, the returns earned on its investment activities, its management team, and its business model. This policy statement is essential to ensure that private capital investors understand that ownership of a U.S. bank or thrift requires them to provide full disclosure to the FDIC of their ownership, operations, profitability, and stability. Such transparency is essential to ensure effective and prudent oversight and regulation by U.S. regulators. Private equity funds and hedge funds that want to keep such information confidential from the FDIC must understand that they are ineligible to take ownership of a failed U.S. bank or thrift.

Limitations. Finally, the proposed guidance would make it plain that nothing in its policy statements would restrict or supercede any other statutory or regulatory requirement related to owning or operating a U.S. bank, including requirements related to a prospective owner's general character, fitness, expertise, and employment of competent management.

More banks and thrifts have failed in 2009 than in the prior decade, and more failures are to come. Each of these failed institutions undergoes analysis by the FDIC to determine whether it should be closed or sold. We cannot afford to have those failed financial institutions sold to new owners without the means, commitment, and expertise to operate them as going concerns. The proposed FDIC guidance will help ensure that only those private capital investors who are willing to make a sustained commitment with full transparency can acquire ownership of our banks and thrifts, and that those investors seeking to make a quick profit at the expense of our communities and our financial system are turned away.

Thank you for this opportunity to comment on the proposed rulemaking.

Sincerely,

Susan M. Collins

Carl Levin

Daniel K. Akaka