

**[6714-01-P]**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**RIN 3064-XXX**

**Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions**

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** **Proposed statement of policy with request for comment.**

**SUMMARY:** The FDIC is proposing to issue a Statement of Policy on Qualifications for Failed Bank Acquisitions (Proposed Policy Statement) to provide guidance to private capital investors interested in acquiring or investing in failed insured depository institutions regarding the terms and conditions for such investments or acquisitions. This Proposed Policy Statement is being published with a request for comment in order to obtain the public's views on the provisions of the policy statement before it becomes effective.

**DATES:** Comments must be received by the FDIC no later than [INSERT DATE THAT IS 30 DAYS FROM THE DATE THAT THE PROPOSED POLICY STATEMENT IS PUBLISHED IN THE FEDERAL REGISTER.]

**ADDRESSES:**

You may submit comments on the Proposed Policy Statement by any of the following methods:

- Agency Web Site: <http://www.FDIC.gov/regulations/laws/federal/notices.html>. Follow instructions for submitting comments on the Agency Web Site.
- E-mail: [Comments@FDIC.gov](mailto:Comments@FDIC.gov). Include RIN # **XXXXXXX** on the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.
- Hand Delivery: Comments may be hand delivered to the guard station at the rear of the 550 17<sup>th</sup> Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

*Instructions:* All comments received will be posted generally without change to <http://www.fdic.gov/regulations/laws/federal/propose.html>, including any personal information provided.

**FOR FURTHER INFORMATION CONTACT:** Catherine Topping, Counsel, Legal Division, (202) 898-3975 or [ctopping@fdic.gov](mailto:ctopping@fdic.gov), Charles A. Fulton, Counsel, Legal Division, (703) 562-2424 or [chfulton@fdic.gov](mailto:chfulton@fdic.gov), or Mindy West, Chief, Policy and Program Development, Division of Supervision and Consumer Protection, (202) 898-7221 or [miwest@fdic.gov](mailto:miwest@fdic.gov).

## **SUPPLEMENTARY INFORMATION**

### **I. BACKGROUND**

Recently, private capital investors have indicated interest in purchasing insured depository institutions in receivership.<sup>1</sup> 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

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<sup>1</sup> 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.

bank in a prudent manner, and accept the responsibility to support their banks when they face difficulties and protect them from insider transactions.

Especially in light of the increased number of bank and thrift failures, and the consequent increase in interest by potential acquirers, the FDIC has evaluated the policies that apply in deciding whether a prospective acquisition is appropriate. The FDIC has reviewed various elements of private capital investment structures and considers that some of these investment structures raise potential safety and soundness considerations and risks to the Deposit Insurance Fund (DIF) as well as important 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. These structuring issues are present with respect to any new proposed acquisition of a failed insured depository institution.

The FDIC is seeking public input on this Proposed Policy Statement. This guidance describes the terms and conditions that private capital investors would be expected to satisfy to obtain eligibility for a proposed acquisition structure. These measures would cover capital support and cross guarantees; transactions with affiliates; secrecy jurisdiction investors; continuity of ownership requirements, and disclosure.

## **II. REQUEST FOR PUBLIC COMMENT**

The FDIC invites comments on all aspects of the Proposed Policy Statement, including the following questions:

1. The measures contained in the Proposed Policy Statement will not be applied to individuals, partnerships, limited liability companies, or corporations, that accept the responsibilities under existing law to serve as responsible custodians of the public interest that is inherent in insured depository institutions, but will be applied to (a) private capital investors in certain companies, proposing to assume deposit liabilities, or both such liabilities and assets, from a failed insured depository institution in receivership (including all entities in such an ownership chain) 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”). Is some other definition more appropriate?
2. The Proposed Policy Statement indicates that so-called “silo” structures would not be considered to be eligible bidders for failed bank assets and liabilities since under these structures beneficial ownership cannot be ascertained, the responsible parties for making decisions are not clearly identified, and/or ownership and control are separated. Are there any reasons why they should be considered to be eligible bidders?
3. One of the most important elements in the Proposed Policy Statement is the requirement that the acquired depository institution be very well capitalized. The text requires a Tier 1 leverage ratio of 15 percent, that this ratio be maintained for a period of at least 3 years, and thereafter that the capital of the insured depository institution remain at a “well capitalized” level. The capital adequacy of depository institutions formed from

assets and/or liabilities acquired from failed banks in receivership is a matter of crucial importance for reasons of safety and soundness and for protection of the Deposit Insurance Fund. This is especially important in the case of newly established banks that, as a general matter, have a weak record of performance in the early years of activity.

In view of these considerations it has been suggested that a Tier 1 leverage ratio of 15 percent included in the text of the Proposed Policy Statement is entirely necessary and appropriate for at least some minimum period after the new depository institution acquisition. On the other hand, it has also been suggested that safety and soundness considerations can be satisfied with a lower, but a still high level, of Tier 1 capital more in line with the level normally applicable to bank or thrift investors subject to prudential regulation, activities restrictions and that serve as a source of strength for their subsidiary institutions. It is also suggested that exceeding such normal capital levels could have the effect of making investments in the assets and liabilities of failed banks and thrifts uncompetitive and uneconomic.

The FDIC seeks to accomplish both objectives in setting initial capital requirements for failed bank asset and liability acquisitions under this Proposed Policy Statement. Clearly, a high level, above normal levels, is necessary to deal with the unusual circumstances facing banking institutions, especially new banking institutions, today. The FDIC seeks the views of commenters on the appropriate level of initial capital that will satisfy safety and soundness concerns without making investments in the assets and liabilities of failed banks and thrifts uncompetitive and uneconomic.

As noted above, the text of the Proposed Policy Statement requires an initial Tier 1 leverage ratio of 15 percent, that this ratio be maintained for a period of at least 3 years, and thereafter that the capital of the insured depository institution remain at a “well capitalized” level. Should there be a further requirement that if capital declines below the required capital level, the institution would be treated as “undercapitalized” for purposes of Prompt Corrective Action and the institution’s regulator would have available all the measures that would be available in such a situation?

4. Should the Source of Strength commitment included in the Proposed Policy Statement be retained in the final policy statement? Should the commitment be enhanced to require from the shell holding company and/or the Investors a broader obligation than only a commitment to raise additional equity or engage in capital qualifying borrowing?

5. Should the Cross Guarantee commitment included in the Proposed Policy Statement be retained in the final policy statement? Should the commitment contained in the Proposed Policy Statement be enhanced by requiring a direct obligation of the Investors?

6. The Proposed Policy Statement limits the use of entities in an ownership structure that are domiciled in bank secrecy jurisdictions unless the investors are subsidiaries of companies that are subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board. Should entities established in bank secrecy jurisdictions be considered to be eligible bidders even without being subject to comprehensive consolidated supervision?

7. Under the Proposed Policy Statement, Investors would be prohibited from selling or otherwise transferring securities of the Investors’ holding company or depository

institution for a 3 year period of time following the acquisition absent the FDIC's prior approval. Is 3 years the correct period of time for limiting sales, or should the period be shorter or longer?

8. The Proposed Policy Statement provides that Investors that directly or indirectly hold 10 percent or more of the equity of a bank or thrift in receivership would not be considered eligible to be a bidder to become an investor in the deposit liabilities, or both such liabilities and assets, of that failed depository institution. Is this exclusion from bidding eligibility appropriate on the basis of the need to assure fairness among all bidders and to avoid an incentive for the 10 percent or more Investor to seek to take advantage of the potential availability of loss sharing by the FDIC if the subsidiary bank or thrift enters into a receivership?

9. Should the limitations in this Proposed Policy Statement be lifted after a certain number of years of successful operation of a bank or thrift holding company? If so, what would be the appropriate timeframe for lifting the conditions? What other criteria should apply? Should all or only some of the conditions be lifted?

### **III. TEXT OF PROPOSED POLICY STATEMENT**

The text of the Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions follows:

#### **Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions**

##### **Introduction**

Capital investments by individuals and limited liability companies acting through holding companies operating within a well developed prudential framework has long been the dominant form of ownership of insured depository institutions. From the perspective of the FDIC's interest as insurer and supervisor of insured depository institutions, this

framework has included, in particular, measures aimed at maintaining well capitalized bank and thrift institutions, support for these banks when they face difficulties, and protections against insider transactions. The ability of the owners to provide financial support to depository institutions with adequate capital and management expertise are essential safeguards. These safeguards are particularly appropriate for owners of insured depository institutions given the important benefits conferred on depository institutions by deposit insurance.

Recently, private capital investors have indicated an interest in participating in acquiring the deposit liabilities, or both such liabilities and assets, of failed insured banks and thrifts in receivership in the current circumstances in which substantial additional capital is needed in the U.S. banking system. The FDIC is keenly aware of this need, particularly as it arises in the context of its function as the receiver of failed insured depository institutions charged with protecting insured deposits based on a congressionally mandated least cost to the insurance fund solutions for these institutions. The FDIC is also aware that new banks, regardless of their investor composition, pose an elevated risk to the deposit insurance fund since they generally lack a core base of business, a proven track record in the banking industry, and are vulnerable to significant losses in the early years of incorporation.

The FDIC is of the view that private capital participation in the acquisition of the deposit liabilities, or both such liabilities and assets, from a failed depository institution in receivership should be consistent with the foregoing basic elements of insured depository institution ownership. The FDIC has reviewed various elements of private capital investment structures for consistency with these principles. Some acquisition arrangements, such as those involving complex and functionally opaque ownership structures, typified by 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, would be so substantially inconsistent with these principles as not to be considered as appropriate for approval for ownership of insured depository institutions. While these structuring issues are generally attributed to private equity ownership investments, the FDIC will apply the same standard of review to any prospective proposed acquisition of a failed bank or thrift to ensure parity and to avoid the creation of loopholes or regulatory arbitrage.

Other ownership structures raise important policy issues that can be addressed so as to meet the principles applied by the FDIC in its decisions on the granting of deposit insurance. The FDIC is particularly concerned that owners of banks and thrifts, whether they are individuals, partnerships, limited liability companies, or corporations, accept the responsibility to serve as responsible custodians of the public interest that is inherent in insured depository institutions and will devote their efforts to assuring that banks or thrifts acquired with assistance from the deposit insurance fund do not return to the category of troubled institutions.

In order 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 date of this 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 standards provide for:

- (a) capital support of the acquired depository institution;
- (b) agreement to a cross guarantee over substantially commonly owned depository institutions;
- (c) limits on transactions with affiliates;
- (d) maintenance of continuity of ownership as specified below; and
- (e) avoidance of secrecy law jurisdiction vehicles as the channel for their investments unless the parent company is subject to consolidated home country supervision.

It is the intention of the FDIC to apply these requirements as set out below.

**Capital Commitment:** Investors would be expected to agree to cause the depository institution acquiring deposit liabilities, or both such liabilities and assets, from a failed depository institution in receivership to be initially capitalized at a minimum 15 percent Tier 1 leverage ratio for a period of 3 years unless the period is extended by the FDIC, and thereafter to maintain the depository institution at no lower level of capital adequacy than “well capitalized” during the remaining period of their ownership. If at any time the depository institution fails to meet this standard, the Investors would have to immediately facilitate restoring the institution to the “well capitalized” standards. Failure to maintain the required capital level will result in the institution being treated as “undercapitalized” for purposes of Prompt Corrective Action triggering all of the measures that would be available to the institution’s regulator in such a situation.

**Source of Strength:** Investors organizational structures subject to the measures provided for in this policy statement would be expected to agree to serve as a source of strength for their subsidiary depository institutions. Source of strength commitments under this paragraph are to be supported by the agreement of the depository institution holding company in which the Investors have invested that holds the stock of such depository institutions to sell equity or engage in capital qualifying borrowing.

**Cross Guarantees:** Investors whose investments, individually or collectively, constitute a majority of the direct or indirect investments in more than one insured depository institution would be expected to pledge to the FDIC their proportionate interests in each such institution to pay for any losses to the deposit insurance fund resulting from the failure of, or assistance provided to, any other such institution.

**Transactions with Affiliates:** All extensions of credit to Investors, their investment funds if any, any affiliates of either, and any portfolio companies (i.e., companies in which the Investors or affiliates invest) by an insured depository institution acquired or controlled by such Investors under this policy statement would be prohibited. For purposes of this policy statement the term "extension of credit" is defined in 12 C.F.R. § 223.3(o) including any subsequent amendments, and the term "affiliate" is any company in which an investor owns 10 percent or more of the equity of that company.

**Secrecy Law Jurisdictions:** Investors employing ownership structures utilizing entities that are domiciled in bank secrecy jurisdictions would not be eligible to own a direct or indirect interest in an insured depository institution unless the Investors are subsidiaries of companies that are subject to comprehensive consolidated supervision ("CCS") as recognized by the Federal Reserve Board, and they execute agreements on the provision of information to the primary federal regulator about the non-domestic Investors' operations and activities; maintain its business books and records (or a duplicate) in the U.S.; consent to the disclosure of information that might be covered by confidentiality or privacy laws and to cooperate with the FDIC, if necessary, in obtaining information maintained by foreign government entities; consent to jurisdiction and designation of an agent for service of process; and consent to be bound by the statutes and regulations administered by the appropriate U.S. federal banking agencies.

**Continuity of Ownership:** Investors subject to this policy statement would be prohibited from selling or otherwise transferring securities of the Investors' holding company or depository institution for a 3 year period of time following the acquisition absent the FDIC's prior approval. This time period is consistent with the current de novo business plan change approval and other requirements in FDIC Deposit Insurance Orders. The FDIC does not expect to approve any sale to a private capital investor during such 3 year period unless the buyer agrees to be subject to the same conditions that are applicable under this policy statement to the selling Investor.

**Special Owner Bid Limitation:** Investors that directly or indirectly hold 10 percent or more of the equity of a bank or thrift in receivership would not be considered eligible to be a bidder to become an investor in the deposit liabilities, or both such liabilities and assets, of that failed depository institution.

**Disclosure:** Investors subject to this policy statement would be expected to submit to the FDIC information about the Investors and all entities in the ownership chain including such information as the size of the capital fund or funds, its diversification, the return profile, the marketing documents, the management team and the business model. In addition, Investors and all entities in the ownership chain will be required to provide

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to the FDIC such other information as is determined to be necessary to assure compliance with this policy statement.

**Limitations:** Nothing in this policy statement is intended to replace or substitute for any determination required by a relevant depository institution's primary federal regulator or a federal bank or thrift holding company regulator under any applicable regulation or statute, including, in particular, bank or thrift holding company statutes, or with respect to determinations made and requirements that may be imposed in connection with the general character, fitness and expertise of the management being proposed by the Investors, 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, and any other supervisory matter.

By order of the Board of Directors.

Dated at Washington, DC, this 2nd day of July, 2009.

FEDERAL DEPOSIT INSURANCE CORPORATION

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Robert E. Feldman  
Executive Secretary

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