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BY EMAIL & FIRST-CLASS MAIL

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Robert E. Feldman, Exec. Sec.
ATTN: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

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

On behalf of Sandler O'Neill + Partners, L.P., I am commenting on the FDIC's Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions.

Sandler O'Neill is a full-service investment banking firm focused on the financial services sector. Our clients include a wide variety of financial firms, among them hundreds of banks and thrifts and their holding companies and private equity firms. As a result, we have broad and deep knowledge of both the depository institutions the FDIC supervises as well as the private equity firms interested in investing in them.

This letter both responds to the agency's request for public comment on its proposed guidance in the July 9th *Federal Register* and reiterates remarks I shared with Chairman Bair and her staff at the July 6th roundtable of banking and investment leaders at the agency's headquarters in Washington, D.C.

The proposed guidance includes some necessary measures that will ultimately strengthen the banking community. The proposed ban on banks extending credit to investors is clearly appropriate and protects bank customers from a potential abuse. Similarly, we agree with the measure disallowing investment by major shareholders of a failed bank into the same institution post-failure. Large owners of a banking institution should not be allowed to abuse their standing.

I appreciate the opportunity to have attended the FDIC roundtable. I thought the candor of the banking and investment leaders in attendance and the FDIC was constructive. We all agree that the banking system is in dire need of private capital. Fresh capital injections from private investors are an important means to a secular recovery in banks, and would minimize cost for the FDIC and the American taxpayer.

Because of the unknowable but daunting magnitude of the financial challenge confronting the FDIC as receiver, we believe the FDIC should encourage the broadest possible spectrum of eligible bidders to participate in the resolution process. When we previously visited the FDIC in late May, we outlined our analysis of potential capital needs and attempted to quantify the number of probable bank failures. Even with regulatory capital forbearance, we concluded a range of 500-1000 banks would require intervention. While the needed equity capital we calculated aggregated less than $30 billion, we projected virtually all of its beneficiaries would be smaller banks with highly limited access to public capital markets. The vast majority would have no other survival alternative than TARP funds.

At this point in the cycle, private equity investors have generally not committed substantial capital, preferring to wait for stronger signs of systemic health or guidelines that allow them to achieve their targeted risk-adjusted returns. However, the acquisition of BankUnited by a private equity group demonstrates the untapped interest.

We do not yet see the necessary measures in this proposal to attract meaningful private capital into the sector. We fear that it would have the opposite effect. The proposal imposes discriminatory burdens that would virtually ensure that no new private equity funds would flow into failed banks. We encourage the FDIC and the banking community to find more common ground on how to bring private investors to the table.

Re-capitalizing the banking industry is not the core objective of bringing private investment into banks. Rather, it is the national economic interest in a reinvigorated credit creation process. Our banking system must not risk turning away willing private investors.

To achieve these ends, we propose that the FDIC be guided by four basic principles in seating private equity firms at the bidder's table.

First, granting the distinction between strategic and private equity investors, the FDIC should nevertheless seek to level the financial playing field.

In particular, the minimum bank-level 15% Tier 1 leverage capital ratio for a period of three years proposed for private equity firms is three times the Prompt Corrective Action "well-capitalized" ratio and almost double the 8% ratio required of de novo applicants for deposit insurance. On its own, it is onerous enough to ward off private equity dollars completely.

Second, the FDIC should defer to existing federal statutes and regulations and Federal Reserve policy in matters relating to permissible ownership structures, source of strength, cross guarantees and affiliate transactions.

For example, the proposed disallowance of "silo" organizational arrangements would further limit private equity participation in bidding when it is not only needed, but likely to become more necessary. Silos are an amalgamation of independent entities that provide meaningful capital to smaller banking institutions that do not have access to public equity markets.

As with the proposed super-minimum capital requirement, there are assertions but no persuasive facts or findings in the proposal to provide a basis for exceeding safety and soundness protections already in place.

Third, the time-tested statutory and policy framework for reviewing applications for deposit insurance is fully sufficient to protect the deposit insurance fund and taxpayers in the resolution of failed depository institutions.

We see no reason to erect a higher standard for private equity investors as a group. There is no basis in fact to do so and it weakens the bidding process for failed banks. The existing framework includes not only the factors of capital adequacy and future earnings prospects but also the general character and fitness of management, to name only three of the seven statutory factors.

Under the proposal, private equity investors would win bids only if they made a lower cost bid than any strategic bidders and would have to do so with greater impediments to profit. Excess capital is justly required in some instances, but shouldn't be for banks funded by investors, and operated by managements, with established track records of turning companies around.

Investors in private equity funds are driven by high, double-digit investment returns over a two- to five-year time frame, requiring the fund to have meaningful say in the management of their portfolio companies. These investors are not an exclusive club of the powerful and well connected. The principal investors are instead public retirement funds, corporate pension funds, union pension funds, foundations and endowments. These institutional investors employ rigorous due diligence and chose private equity for its track record of high rates of return.

Another instance where the proposed guidance would constrict the flow of private capital is the "source of strength" obligation. This rightly requires that a failed bank be able raise new capital and avert another failure. But it appears that the proposal would extend that obligation beyond holding companies and onto private capital investors, creating what amounts to unlimited liability. At the same time, it would preclude most private equity firms from investing because it directly conflicts with their general partnership agreements. Moreover, several recent high-profile bank failures discredit the source of strength concept.

Fourth, the FDIC should consider alternative structures.

Instead of modifying existing guidelines, we agree with the FDIC's recently expressed concept of segregating distressed bank assets for purchase by private investors.

Since it became clear that the banking system would have difficulty tapping private sources of capital, we have envisioned a middle way for private equity firms between holding company status on the one hand and asset purchases (without deposits) on the other. We could conceive of a structure wherein private equity firms could be permitted to make investments in failed banks up to 24.9% of their value. Ownership and control within the failed institution could be bifurcated and troubled legacy assets segregated. Private equity stake(s), together with co-investment by the FDIC, would have to equal or exceed the value of troubled legacy assets, which would therefore not be funded by insured deposits.

Private equity firms would be tasked with managing and disposing of troubled legacy assets, but would be involved in management of the remainder of the bank only to the extent of representation on the board of directors. Proceeds from liquidating legacy assets could be invested by bank management. The FDIC (and the public) would share in the proceeds of any future sale of the bank in proportion to its equity co-investment.

Such an arrangement would give the FDIC potential upside not provided by loss sharing and would address concerns over control by private equity investors in the absence of bank holding company status and supervision.

This is merely one idea to contemplate. Another is for the FDIC to maintain an ownership stake in the new entity. The private equity community will certainly have additional ideas that merit consideration. These alternatives would not necessarily need to replace your original proposal, modified or not, but would afford more choices for the private equity community to consider.

Encourage private investment

Private equity investment has before, and could again fuel a turnaround for the banking sector. Private equity firms are not mercenaries looking to capitalize on the American taxpayer – through their diverse investor base, they *are* the American taxpayer. Though the proposal includes some constructive components, and we respect the FDIC's mission to protect

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banks and the public, policy must be fashioned to encourage the investment of critically important private capital that banks need now.

We welcome any opportunity this letter affords to continue our dialogue with the FDIC on these topics. We appreciate the tremendous dedication shown by the FDIC in this crucial stage of our nation's recovery. We hope you find these remarks helpful. Thank you for your consideration.

Very truly yours,

James J. Dunne III
Senior Managing Principal

cc: The Honorable Sheila C. Bair, Chairman
Board of Directors of the Federal Deposit Insurance Corporation

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System

The Honorable Timothy F. Geithner, Secretary
United States Department of the Treasury