OAKTREE

Oaktree Capital Management, L.P.
333 South Grand Avenue, 28th floor
Los Angeles, CA 90071

p 213 830-6300
www.oaktreecapital.com

August 7, 2009

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

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

Dear Mr. Feldman:

Oaktree Capital Management, L.P. ("Oaktree") welcomes the opportunity to respond to the Federal Deposit Insurance Corporation's ("FDIC") request for public comment on the Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions (the "Statement") issued on July 2, 2009.

Oaktree is a global investment manager focused on risk-controlled investments in private equity, distressed debt, real estate and other credit-related strategies, with over $51 billion of assets under management as of March 31, 2009. Our investors include public pension plans from 34 of the 50 states, 62 of 100 largest U.S. pension plans and over 280 colleges, universities, endowments and foundations.

We support the FDIC's efforts to strengthen the banking industry and to protect the Deposit Insurance Fund ("DIF"). We acknowledge the FDIC's desire to ensure that those who control banks and thrifts have experience and competence in operating such institutions in a prudent manner and that they maintain financially sound, well capitalized institutions. We also understand the pressing need for substantial amounts of new capital in the banking sector and the FDIC's interest in facilitating this investment in a manner consistent with these objectives.

Oaktree, like many of its peers in the alternative asset management space, is prepared to invest substantial capital in troubled banking institutions. "Private capital investors"[1] have a long history of supporting failing institutions and helping manage them to financial health. Struggling banks have an even greater need for private capital today than in prior economic downturns, as many strategic buyers are dealing with their own increasing asset quality problems. However, if the FDIC adopts the Statement as proposed, the additional costs, burdens and uncertainties imposed by the Statement would significantly reduce or eliminate our willingness to invest in banking institutions.

We have the following specific comments on the Statement.

I. Maintenance of 15 Percent Tier 1 Leverage for Three Years

The Statement would require that institutions with "private capital investors" maintain a Tier 1 leverage ratio of fifteen percent (15%) for at least three years following the investment. This requirement is a multiple of the eight percent (8%) ratio required for a newly organized institution and the five percent (5%) ratio required for an existing institution to be considered "well capitalized." Few, if any, of the soundest financial institutions in this country maintain a Tier 1 leverage ratio of fifteen percent (15%).

The Statement unfairly and without justification discriminates between institutions with "private capital investors" and those without such investors. Ownership of banks by "private capital investors" does not present additional risks that warrant such extreme measures. Current law identifies specific factors to be considered by regulatory authorities when evaluating the safety and soundness of a proposed acquisition or investment in a banking institution. Congress did not create any distinction based on whether or not an applicant is a "private capital investor" or provide a basis to favor managers and institutions whose securities are publicly held. The determination of appropriate capitalization should be tied to a bank's record of performance and the quality of its relevant management team. There is nothing about investment by "private capital investors" that, by its nature, should require in all instances that an institution hold more capital than would otherwise be required if the institution was owned by other investors.

Imposing such an extraordinary capital requirement would significantly increase the cost to the DIF, the banking industry and taxpayers of resolving a growing number of troubled institutions. Bids by "private capital investors" would need to account for capital requirements that are two to three times the amount of capital required of institutions without such investors. Consequently,

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[1] Currently, the Statement does not define the term "private capital investor." Regardless of the manner in which the term is ultimately defined, the reach of the Statement should not extend to an investor or a group of investors who are not seeking to acquire control of a banking institution. Without further clarification, the Statement could be read broadly to apply to minority investments in banking institutions.

the number and terms of bids for insolvent institutions would be fewer and less favorable to the DIF. In fact, we expect that "private capital investors" would simply determine that the Statement so unbalances the playing field against such investors as to make bidding pointless. The Statement would thus have the unintended consequence of undermining the FDIC's statutorily mandated charge of ensuring that failed institutions are resolved in a manner that will result in the least cost to the DIF. Equally troubling, such high capital requirements may have other unintended consequences such as the possibility that increased risk in the post acquisition business strategy will lead to higher interest rates on loans or higher fees in efforts to offset the disproportionately higher cost of capital.

We respectfully suggest that the FDIC set the minimum Tier 1 leverage capital ratio at eight percent (8%), which is consistent with its historic practice, and that any determination to set a higher capital level be done on a case-by-case basis taking into account the quality of the capital contributed, the strength and experience of the management team, the risks inherent in the business plan and other similar factors.

II. <u>Investors Liable Under Cross-Guarantee for Cost of Institution Failure</u>

The Statement would impose a new form of cross-guarantee liability on multiple investors that collectively own a majority of two or more insured depository institutions. Under current law, cross-guarantee liability exists only where two institutions are under the control of a single common holding company.

Current law is designed to deter holding companies that control two institutions from "writing off" a struggling bank subsidiary and passing the cost of its failure onto the DIF. No such policy justification exists where the two institutions are not under common control. In many cases, we would expect the applicable regulators to impose express prohibitions on our ability to influence or transact business with the institution in which we invest. While the current parameters of cross-guarantee liability make sense, the Statement's expansion lacks a sound rationale when imposed with respect to an investor that has made non-controlling investments in two or more unrelated institutions.

The proposed new form of cross-guarantee liability would create fundamental problems for the majority of private equity firms, which manage more than one fund. Such funds typically are separate legal entities with different investors, investment criteria and objectives. The proposed cross-guarantee liability would create the possibility that investors in one fund would be at risk for an investment made in another fund in which they have no interest. It is unreasonable to expect our investors (which consist mostly of pension plans, endowments and foundations) to accept this type of risk.

In addition, we are concerned by the lack of clarity in the Statement as to how cross-guarantee obligations would apply. The FDIC's proposal that a cross-guarantee be required in situations

where a group of private equity firms owns a majority of the shares of each of two banks does not describe the manner in which different combinations of investors would be counted. The Statement presents computational challenges in calculating share percentages in situations where groups of investors participate in more than one investment in the sector. In the absence of a clear understanding as to how these obligations are to be applied to various fact patterns, "private capital investors" will choose not to invest in more than one institution. Given the scope of the problems facing the banking industry, it seems prudent to encourage multiple investments throughout the sector by investors such as private equity funds.

The Statement leaves unanswered the following important question: What would the FDIC do if it became the majority owner of an institution pursuant to the proposed cross-guarantee pledge? The answer to this question affects not only the overlapping "private capital investors"—but also the unrelated shareholders and management of the healthy institution. The Statement's proposed expansion of cross-guarantee also raises the fundamental policy question whether the government should acquire control of healthy banking institutions. The Statement does not address any of these important issues.

For these reasons, we believe that that a cross-guarantee provision will make it more difficult to assemble a consortium of investors to purchase failed banks, and, therefore, we respectfully suggest that it not be included in the final Statement. If, however, the FDIC decides to retain such a provision, we believe the triggering overlap percentage of common investors should be set at a sufficiently high level (such as eighty percent (80%), which would be analogous to the common ownership threshold for banks to be exempt from the main restrictions of the Federal Reserve's Regulation W) that it applies to situations where investors are consciously acting together rather than incidental or coincidental cross-ownership.

III. Expanded Source of Strength Commitment to Support an Institution

Existing regulatory practice requires companies that *control* a bank to serve as a "source of strength" for their subsidiary banks. The Statement would expand this obligation to companies that *control* a thrift, an expansion with which we agree.

However, we strongly disagree with any policy that would create or imply a "source of strength" obligation for investors that *do not control* a bank or thrift. The rationale for the existing "source of strength" doctrine is that a company with control of a bank has the ability to affect the bank's success or failure—and should therefore be responsible for supporting the bank if it becomes troubled. There is not a sound rationale for extending this obligation to an investor that has no ability to control the institution. The imposition of broad and unlimited support obligations on a non-controlling investor would virtually eliminate the willingness of individuals, companies and private equity funds to invest in the banking industry.

We recommend that the FDIC affirmatively confirm that the Statement does not seek to expand the source of strength doctrine to investors who do not control a bank or thrift.[2]

In addition, the FDIC has sought comments with respect to the idea of expanding the requirement to include not only bank holding companies, but also investors who are not bank holding companies. As a basic equitable tenet, we believe that imposing financial obligations on non-controlling investors would be unreasonable–since these non-controlling investors by definition are not able to unilaterally implement measures to prevent or remedy the problems which gave rise to the need for additional capital, they should not be asked to assume unlimited liability for resolving those problems. Further, as a practical matter for a fund, this type of broader obligation would be prohibited by the terms of a standard private equity fund. Private equity funds generally are required to diversify their investments, and often have express limitations as to the amount of capital that can be funded with respect to a single investment, or a group of investments in a particular sector. Additionally, private equity funds generally contain contractual limits on the aggregate amount of capital contributions that are required to be funded by each investor over the life of the fund. If the “source of strength” doctrine were applicable to a private equity fund that does not control a bank or thrift, the fund may be required to call capital from investors in amounts that exceed the contractual limits. Given this possibility, the application of the doctrine would effectively preclude the investment in banks or thrifts by many private equity funds.

IV. Bank Secrecy Jurisdictions

The Statement’s prohibition on entities in “bank secrecy jurisdictions” could create a practical bar on investment by many fund organizations with non-U.S. investors. The Statement would prohibit any “private capital investor” with entities in a “bank secrecy jurisdiction” from investing in a banking institution. Like most investment funds with non-U.S. investors, Oaktree uses one or more offshore vehicles to ensure efficient tax treatment for its foreign investors. These vehicles are often organized in the Cayman Islands, Bermuda, Guernsey or Netherlands Antilles. A prohibition on using any offshore entities in an ownership structure could restrict “private capital investors” from using traditional funding structures that provide tax and other efficiencies, thereby hampering their ability to bid for failed depository institutions. We believe that a non-controlling investor that satisfies the FDIC’s information requests as specified in the Statement should be permitted to use traditional offshore funding structures, particularly if the ultimate controlling person or entity of those offshore vehicles will be domiciled in the United States.

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[2] An overlapping issue is raised by the Statement’s use of the word “facilitate” in regards to the obligation of investors to further capitalize an institution that falls below the proposed capital requirements. We respectfully request that the FDIC amend the Statement to clarify that this would not require direct contribution of capital by non-controlling investors in a bank holding company and that what is contemplated is support for things like charter amendments that increase the authorized share capital.

V. Continuity of Ownership

Under the Statement, "private capital investors" in an institution that seeks to participate in an FDIC resolution would not be permitted to sell or transfer any interest in that institution for three years. As a practical matter, the Oaktree funds that would be making an investment in a failed depository institution have ten (10) year lives and, by definition, have a long-term investment horizon. As experienced distressed investors, we understand that it takes time and significant commitment to heal damaged organizations to create shareholder value. However, the Statement's three-year continuity requirement could preclude or deter investment by private equity firms, particularly where they plan to make follow-on investments over time. Like many other "private capital investors," Oaktree believes that a well capitalized bank with a strong management team could be in a position to acquire other troubled or failed institutions—creating more competitive FDIC auctions and thereby reducing associated losses to the DIF. Imposing the proposed three-year period and re-starting the clock after each new or follow-on investment would be unfair, unnecessary and would diminish the willingness of "private capital investors" to make such investments. Further, while we understand that a shorter holding period of perhaps eighteen (18) months has some benefits in terms of stability, precluding an initial public offering during the holding period, even where the proceeds of the initial public offering go to the bank itself, is counter to the objective of increasing capital of banks.

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Oaktree greatly appreciates this opportunity to comment on the Statement. We would be pleased to further discuss any of the issues raised in this letter. Please feel free to contact me at (213) 830-6300 with any questions or comments that you may have.

Sincerely yours,

John B. Frank
Managing Principal