From: Michael L. Campbell
Sent: Monday, August 10, 2009 12:27 PM
To: Comments
Subject: Statement of Policy, July 9, 2009 - RIN 3064-AD47

August 10, 2009

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

Attention: Comments

Re: Proposed Policy Statement on Qualifications for Failed Bank Acquisitions

Dear Mr. Feldman:

The Council of Urban Professionals (CUP), Phene Capital, LLC (Phene), and Provident Group Asset Management (PGAM) appreciate the opportunity to provide comments on the Federal Deposit Insurance Corporation's (FDIC) Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions (referred to hereafter as the "Proposed Statement"). While we appreciate the FDIC's efforts to create transparent, uniform rules for failed bank acquisitions and its efforts to protect the deposit insurance fund, we are gravely concerned that the rules as proposed would have the effect of deterring private investors from placing bids on failed banks and depriving the banking system of much-needed capital. We are particularly concerned about the impact of the proposed rules on the nation's minority depository institutions (MDIs), the communities those MDIs serve, and the private investment funds that operate in that space.

As you know, under section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the FDIC has a statutory mandate to preserve and encourage minority ownership of depository institutions. As Director Sandra Thompson explained in her October 30, 2007 Congressional testimony before the Subcommittee on Oversight and Investigations of the Financial Services Committee, the now 218 MDIs currently in operation "serve as a key source of credit and other banking services essential to economic growth and business development in areas that are often underserved by traditional depository institutions." Unfortunately, in spite of this public policy support, MDIs have historically faced difficulties accessing external capital on terms comparable to traditional depository institutions. In addition, MDIs' return on assets (ROA) has generally lagged behind that of non-minority owned peers, resulting in less internally-generated capital. These factors have not only curtailed the ability of MDIs to extend credit to entrepreneurs in their communities, but also left some of these institutions with insufficient capital buffers to withstand the historic economic downturn of the past eighteen months.

While the vast majority of MDIs are well capitalized, the FDIC’s most recent data reveal that 28 MDIs have a Tier 1 leverage ratio of less than 7 percent and 7 MDIs have a Tier 1 leverage ratio of less than 5 percent. Accordingly, the FDIC should consider, in light of its section 308 obligations, the potential adverse impact the Proposed Statement would have on the likelihood that a failed minority-owned institution would be acquired in a manner that would preserve minority ownership.

It is our fear that by restricting the pool of available capital, the Proposed Statement would erect new policy barriers to continued minority ownership of banks. During the last period of stress in the banking system (April 1998 to June 2002) six minority-owned institutions failed. Fortunately, much of the sector remained sufficiently healthy to allow four of those banks to be acquired by other minority-owned institutions. Given the depth of the current crisis and the effect it has had on loan performance in minority communities, it seems unlikely that enough strategic bidders will be available to achieve the same 67% minority-ownership preservation rate this time around. We strongly believe that in order to improve upon or match previous rates, the FDIC will need greater involvement from another critical market and source of capital - private investment funds - in purchase and assumption transactions.

Greater participation among such investors would also advance the long-standing federal policy objective of broadening the playing field and expanding access to capital. The fact is that 89 percent of MDIs have less than $1 billion in total assets and 36 percent have balance sheets smaller than $100 million. The $1 million to $100 million minority investments that would be necessary to recapitalize these institutions in the event of failure are simply too small to be attractive to large private equity investors or the large asset management firms that recapitalized the 19 largest banks as part of the Supervisory Capital Assessment Program (SCAP). The reality is that the only private sources of capital that are likely available for these kinds of investments are smaller private investment funds that often focus on underserved communities and, in many cases, possess specialized knowledge of minority-owned institutions’ asset base and loan book. Yet, as currently drafted the Proposed Statement does as much to deter these bidders as it does larger private investors.

It is important to recognize that if these smaller private investment firms that focus on minority and underserved communities are effectively barred from making investments in failed banks in their own backyard, it is highly likely that their returns will underperform those of their peers. This will hurt these investors the next time they seek to raise capital from private investors. The result will be fewer funds focused on underserved communities, less capital available to minority entrepreneurs, and dimmer economic prospects for communities all across the country.

Having spelled out what we believe to be the very real threats posed by the Proposed Statement, we wish to briefly summarize the sections we believe should be changed to allow private investors to participate on equal footing with other bidders in auctions involving failed banks.

Parties to whom the Proposed Statement Should Apply. The FDIC is rightly concerned that the owners of banks have the requisite skills, experience, and financial capacity to run insured depository institutions in a prudent manner. However, the proposed Statement assumes without substantiation that banks owned by certain categories of private investors would not possess these "safeguards." Private investment funds are no less likely to back management teams meet these tests than strategic investors. As explained above, the nation's largest asset management firms have taken large passive ownership stakes in the banks that participated in the SCAP. The Proposed Statement should not treat private investment funds seeking to take similar passive ownership stakes in the smaller, failed banks in their communities any differently.

Capital Commitment. Perhaps the largest deterrent to private investment in failed banks is the proposed 15 percent Tier 1 leverage ratio requirement. This would require banks rescued by private investment funds to hold three times as much capital as is required to be considered "well capitalized" by banking regulators. Since 2004, the average leverage ratio at FDIC-insured commercial banks was 7.72 percent, or roughly one-half of the capital that the Proposed Statement would require of banks rescued by private investors. Finally, this standard would again create a disparity between what was required of the large asset managers that recapitalized the SCAP banks and the private investors seeking to recapitalize smaller banks in their backyards. As part of the SCAP, banks were required only to maintain capital equal to 4 percent of *risk-weighted* assets. Higher requirements would reduce private investors' investor returns relative those earned by larger investors in public financial institutions and make it more difficult for MDIs recapitalized by private investors to compete with traditional lenders in those cases where their books of business overlap. More significantly, it would reduce the likelihood that private investors' bids would succeed, as the higher mandated capital would cause investors to make more conservative valuations of failed institutions' assets. It is important to remember that even prior to the current recession MDIs had lower levels of noninterest income and higher levels of loan-loss provisions than the rest of the industry. Private investment funds cannot place their investors' capital at undue risk by placing bids on these pools of assets that do not present the prospect of competitive returns. To provide private investment funds with the opportunity to make bids that are not only competitive with strategic investors but also in excess of the FDIC's estimated liquidation value, we recommend eliminating the proposed capital standard and replacing it with the same common equity capital required of the banks participating in the SCAP, perhaps with some reasonable additional premium to address the FDIC's policy concerns.

Cross-Guarantees. We believe it is entirely inappropriate to require private investors that do not exercise control over a depository institution to pledge assets to the FDIC simply because the same investment fund may own a non-controlling stake in another, unaffiliated depository institution. This proposal deviates greatly from the Federal Deposit Insurance Act's cross-guarantee liability provisions, which are not triggered unless the depository institutions are *controlled* by the same company. Investors in many private investment funds are only willing to invest based on the same promise of limited liability afforded to the owners of publicly traded shares in large banks. We recommend eliminating this provision from the Proposed Statement.

Transactions with affiliates. While we certainly understand the need to ensure that non-controlling investors in failed banks are not able to use their equity ownership or potential representation on the Board of Directors to divert credit towards affiliated businesses, we believe Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve's Regulations O and W provide sufficient protections. These provisions govern transactions between insured depository institutions and nonbank affiliates in ways that preserve the bank's flexibility while also providing safeguards against potential abuse. In the event that the FDIC believes more protection is required, we would ask that the Proposed Statement grandfather existing extensions of credit that had been extended prior to the failure and subsequent change in ownership.

Continuity of Ownership. We recommend that the FDIC shorten its proposed holding period to 18 months. While the vast majority of private investments in failed banks would be unaffected by the required three year holding period, a prohibition on the sale of ownership interests introduces a liquidity risk that could deter some investors from placing bids. An 18 month requirement would alleviate these concerns while still ensuring that potential investors do not have an excessively short-term orientation.

We appreciate the opportunity to provide comments on this important matter and thank the FDIC in advance for its attention to our concerns. While we certainly understand the competing interests the FDIC must attempt to balance, as currently drafted the Proposed Statement would reduce MDIs' access to capital, place downward pressure on minority ownership rates, and penalize private investment funds that focus on underserved communities. These outcomes would not only be contrary to the FDIC's statutory obligations, they would also undermine the government's long-standing policy objective to expand access to capital, level the playing field, and broaden our nation's prosperity. The future of minority-owned and minority-focused institutions is inexorably linked to the future of the communities which they serve. We ask that the FDIC keep this is mind when considering changes to the Proposed Statement.

Sincerely,

Chloe Drew, Executive Director
The Council of Urban Professionals

Michael L. Campbell, Managing Partner
Phene Capital, LLC

Brian Mathis, Co-Managing Partner
Provident Group Asset Management