August 10, 2009

VIA E-MAIL (comments@FDIC.gov) AND U.S. MAIL

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

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

Ladies and Gentlemen:

On behalf of Lone Star Funds ("Lone Star"), we appreciate the opportunity to comment on the Federal Deposit Insurance Corporation's (the "FDIC") Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions (the "Proposed Policy"). We also look forward to working to support the FDIC to most effectively and efficiently achieve its mission of maintaining stability and public confidence in the nation's financial system during these difficult times.

Lone Star is a global investment firm that focuses on investment in distressed financial assets and institutions around the world. Lone Star's origins trace back to the U.S. savings & loan crisis in the late 1980s to early 1990s, when key figures of Lone Star's senior management were instrumental in the design and implementation of a highly successful public-private partnership with the FDIC and Resolution Trust Corporation (called the Brazos AMDA partnership) to resolve a large volume of nonperforming loans and associated real estate assumed by the FDIC/RTC from failed institutions. From this working relationship with the U.S. banking regulators, Lone Star developed its operations, policies, and underwriting methodologies based on traditional banking analytics and credit principles.

Since then, Lone Star has invested more than $60 billion, predominantly in large-scale acquisitions of nonperforming loans and related securities from financial institutions around the world (directly and through intermediaries like the FDIC), as well as controlling equity investments in insolvent or undercapitalized financial institutions in Japan, South Korea, and Germany. Lone Star has collaborated effectively with banking regulators and policymakers worldwide to successfully rehabilitate these troubled financial institutions in a prudent and cost-effective manner. Given this experience, and

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the conservative, intensely credit-focused analysis that underlies it all, we hope to offer a broad-based perspective that will be useful in the FDIC's deliberations.

General Comments

Lone Star welcomes and supports the FDIC's initiative to provide clear guidance concerning the requirements for investors to be considered acceptable bidders for failed institutions. However, we have serious concerns that the Proposed Policy, if finalized as is, would have the effect of sidelining the substantial amount of private capital that would be available, under reasonable conditions, to support the FDIC in resolving failed institutions. Given the enormity of that task, it is vital that the FDIC not unnecessarily exclude any appropriate capital base from participation. To do so would undoubtedly serve to increase substantially the ultimate cost of the resolution to the FDIC, the banking system, and the U.S. taxpayer, without any clear benefits.

The Proposed Policy uncovers a strong bias against, and suspicion of, "private" capital, seemingly aimed mainly at private equity funds. It is not articulated, nor is it apparent, what is at the root of this suspicion. While we all are cognizant of the distinctions between "strategic" capital and "financial" or "private" capital, we are not aware of any empirical evidence that private investors categorically present any greater risks to particular institutions or the banking system as a whole than "traditional" investors. As our own track record shows, through the recapitalization and management of four banks with combined assets of more than $200 billion, private equity firms with specialized expertise in the financial sector can have an important and beneficial impact on restoring the stability of and public confidence in the banking system, to the benefit of regulators, borrowers, and taxpayers.

Of course, there will be private investors that the FDIC and the institution's regulators may not consider appropriate owners of substantial interests in a particular (or maybe any) banking institution, or that would be acceptable only with substantial protections along the lines of those included in the Proposed Policy. But it is just as clear, if not more so, that many private capital investors bring to this problem a deep and rich understanding of the issues facing the banking system today, and experience and expertise, together with the necessary capital, to positively contribute to the FDIC's task of resolving what will likely be hundreds of failed institutions (and many hundreds more that have not failed but that just as clearly will need substantial capital infusions to become properly functioning lending institutions for the communities and markets they serve).

We appreciate that the fundamental goal of the Proposed Policy is to enhance the stability and public confidence in the nation's financial system. Historically, the time-tested way to fulfill this goal has been to rely on a broad, principle-based framework that accommodates the prudent exercise of discretion by the banking regulators, including the FDIC. Within that framework, regulators can identify the right approach for a given

situation, aimed at restoring the financial institution to a prudent, properly functioning lending institution, serving individuals and companies in its market. Notwithstanding the current crisis, we do not believe it would be beneficial to veer away from this model now, especially in the singular context of broadly defined "private capital" investments in financial institutions. We are confident that there is an abundance of "good" private capital, highly experienced and specialized in financial institutions, that is ready and willing to assist the FDIC in the resolution of failed and at-risk institutions. The FDIC's policies should permit ready access to this capital while instituting sufficient safeguards against investment by any organization or investor that is considered "too risky" for the role of responsible custodian of the public's trust, based on its particular facts and circumstances.

Specific Questions

Question 1: Scope of the Proposed Policy Statement

Response: It is difficult to define properly the scope of the Proposed Policy until it is clear what conditions are to be imposed on those covered by it. While we disagree with some of the specifics of the proposal (as detailed below), we assume its goal, with which we would agree, is to maintain the stability of the nation's banking system by ensuring that the proposed investor is properly screened by the relevant regulatory bodies and law enforcement agencies and can demonstrate the requisite level of capital support, management expertise, and appreciation for the fundamental goal of preserving the safety and soundness of the institution, and ultimately the banking system as a whole. From that perspective it would seem the Proposed Policy should apply to *all* investors.

Question 2: Ownership, Transparency, and "Silo" Structures

Response: We agree that any structure that is not sufficiently transparent, such that ultimate beneficial ownership cannot be ascertained, the responsible parties for making decisions are not clearly identified, and/or ownership and control are separated in some opaque fashion, would be problematic and therefore should not be permitted. Having said that, most ownership structures that we have seen that are commonly referred to as "silo" structures do not have these features, and therefore we assume they would not be objectionable. Put another way, as long as ownership can be ascertained, responsible parties identified, and control of the institution is and remains clear to the FDIC and the relevant regulators, such a structure should not cause undue concern; accordingly the investor in that situation should not be excluded from consideration solely on the basis of the organizational structure.

We would note that, in our experience, the so-called "silo" structures are generally proposed in situations where an investor contemplates having a controlling (i.e., greater than 24.9%) interest in the institution, but also has other investments or unrelated

activities. The investor therefore creates a separate legal structure for the investment in the financial institution and its parent company, both of which would be chartered and regulated (as a financial institution and a BHC, respectively), while the investor's other non-financial institution activities would not be regulated. If such "silo" structures were not permitted, the most likely alternative approach that has surfaced in several instances recently is a "club" or "consortium" deal, in which several investors invest together, with no investor owning more than 24.9% of the institution; in this manner, none of the investors is a BHC, and thus each avoids regulation. This alternative approach, we believe, raises a number of policy concerns:

1. We would expect regulators, in general, to prefer that investors bidding for failed financial institutions be willing to organize as BHCs, even if under a transparent "silo" structure, since that structure would give regulators the broadest powers possible to ensure safety and soundness under the BHC Act.

2. "Club" or "consortium" arrangements necessarily reduce the number of potential bidders for a given institution, which leads to less competition, lower bid prices, and thus an increased burden on the Deposit Insurance Fund.

3. A majority owner has more responsibility and accountability for overseeing an effective turnaround of a failed bank than a group of minority investors who might fall prey to a collective avoidance of responsibility and potential conflicts of interests. Simply by becoming a majority owner, an investor demonstrates a deeper commitment to the failed institution and to restoring its health. The Federal Reserve's own research has shown that banks affiliated with a holding company that has full ownership have a lower probability of future financial distress, are more likely to receive capital injections if needed, and recover more quickly than other banks[1].

For these reasons, we believe the FDIC should encourage full ownership and full responsibility for investors in failed institutions, even via a "silo" structure, as long as the specific concerns the FDIC has with such a structure are addressed directly by the applicant.

Question 3: Capital Commitment

Response: As has been reflected in many of the comments submitted by other parties, requiring an extraordinarily high level of Tier 1 capital in all cases involving private investors does not appear to be warranted. It would create a severely anti-competitive environment for those subject to the Proposed Policy, and thus would almost certainly result in the exclusion of a vast amount of much-needed capital and management talent

[1] *Federal Reserve Bank of New York Staff Reports,* no. 189, "Are Bank Holding Companies a Source of Strength to Their Banking Subsidiaries," Adam B. Ashcraft, June 2004.

from the critical rehabilitation of the banking system. Unavoidably, this would meaningfully increase the ultimate costs to the Deposit Insurance Fund, the banking industry, and the U.S. taxpayer.

In concept, the Proposed Policy takes a "lowest common denominator" approach to determining what capital ratio is appropriate for a failed institution. It is likely that certain situations present unique risks that would lead to a prudent conclusion that the institution's initial Tier 1 capital should be extraordinarily high to protect against those singular risks. On the other hand, it will almost surely also be the case that certain institutions that will be recapitalized and managed by "private capital" would present a risk profile that wouldn't differ meaningfully from a longstanding, healthy institution. Certainly, one can contemplate those situations where a newly recapitalized institution with an experienced bank management team would present less risk than a true de novo institution. In those situations, there simply is no basis for requiring higher capital ratios than have been required historically for de novo institutions.

In sum, the amount of Tier 1 capital that is prudent for a particular institution depends on many factors, including in particular the depth and breadth of experience of the bank management team, the institution's articulated business plan and growth prospects, the character and quality of the bank's assets, risk mitigants (such as loss-sharing arrangements, if any, relating to legacy assets), and other sources of capital available to the institution (whether under the general source of strength doctrine or contractual support arrangements). As a result, the FDIC (and the institution's regulators) should maintain the flexibility to require higher Tier 1 capital ratios in those situations where it is in fact warranted due to the particular risks faced by an institution, but not blindly in all situations where "private" investors (however that term is ultimately defined) recapitalize a failed financial institution.

Similarly, the institution's ongoing capital requirements would seemingly be prudently addressed under the existing rules, recognizing again that in particularly risky situations a more stringent test could be considered on a case-by-case basis.

Question 4: Source of Strength

Response: We agree that an institution that becomes weak should have clear access to raise additional capital from any sources available, without undue interference from existing shareholders.

Question 5: Cross Guarantees

Response: We appreciate that if an investor has a controlling interest in multiple institutions, it would not seem to be overreaching to require those institutions to support each other if one bank becomes weak. However, such an obligation has to be balanced

against any contractual or fiduciary obligations that the fund manager faces if it is investing across multiple funds that may have disparate pools of investors.

For example, if a single private equity fund acquired controlling interests in two or more financial institutions, it may be appropriate to require that those institutions be held under a single bank holding company or otherwise provide for cross-support between the institutions. On the other hand, if a private equity fund manager acquires two financial institutions through separate funds that have distinct investors (though possibly with some overlap from fund to fund), requiring cross-support between those institutions is likely prohibited under the funds' respective controlling agreements – and in any case it would seem inappropriate to force one group of investors to support the investment decisions of an unrelated group. Thus unless such an investment in financial institutions via separate funds were excluded from the cross guarantee requirement, the fund could effectively be precluded from making the investment in the second institution. That would be unfortunate, as we would expect that if a private equity manager has successfully worked with the FDIC and regulators in the past to recapitalize a distressed bank, the FDIC would welcome that organization to assist with an additional failed institution.

Question 6: Secrecy Law Jurisdictions

Response: As with the discussion of "silo" structures, entities organized in jurisdictions that have bank secrecy laws, etc., do not necessarily lack the appropriate transparency to effectively assess and monitor a particular investor. In those situations, rather than categorically excluding such entities from involvement in an investment in a U.S. institution, the FDIC and the regulators should require that the investor provide complete disclosure of its ownership structure, including beneficial ownership and management, as well as the other information, etc., required under the Proposed Policy.

Question 7: Continuity of Ownership

Response: We do not have a strong objection to the tenor of the contractual "lock-up" required for investment in an insured institution. While we understand that to date such requirements have generally been for shorter periods than three years, and we feel that such arrangements adequately balance the interests of the investor and the government and public at large, our experience investing in four banks suggests that it generally takes three years or longer to return the bank to a properly functioning, robust and well-managed lending institution. The Proposed Policy should, however, clarify that it does not preclude an institution from raising additional capital through a public or private offering at any time, as any increase in the capital of the institution would seemingly be welcomed by the regulators (subject to approval of any new large investor).

Question 8: Special Owner Bid Limitations

Response: We agree that exclusion would likely be warranted in almost all circumstances.

Question 9: Time Limitations

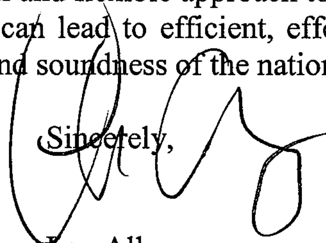
Response: As discussed above, fundamentally we believe that an institution, once it has been recapitalized and new management installed, should not be distinguished from any other institution with respect to risk management. Of course, transparency and adequate disclosure are a constant.

Other Comments: Transactions with Affiliates

In addition to these specific questions, we would also offer a comment on the prohibition of lending to affiliates. We understand and agree with the concern that investors in institutions should not be in a position to cause the institution to imprudently provide funding (through loans or otherwise) to the investor's other business endeavors, and so any such interaction should be tightly proscribed. However, with appropriate safeguards, it may be prudent to allow the institution, on a tightly defined basis, to make such loans. For example, extensions of credit to affiliates could be permitted with the approval of the relevant banking regulator, and/or subject to approval by an independent committee of its Board of Directors, possibly only under certain conditions that ensure that the activity is on arms' length terms and serves the business interests of the institution on a standalone basis (for example, if the institution only participates in a syndicated loan arranged by another, independent institution, and where the affiliated institution is not the lead or largest participant, etc.).

In conclusion, we appreciate the opportunity to offer you our perspective on this vital initiative. We would be pleased to elaborate on any of these comments if you would find that helpful. From our experience working with the FDIC following the S&L crisis, as well as with other financial regulators and policymakers around the world over the last decade, we know that a thoughtful and flexible approach to combining the best of private and public capital and expertise can lead to efficient, effective solutions to the current crisis and to restoring the safety and soundness of the nation's banking system.

Sincerely,



Len Allen
Senior Managing Director