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August 7, 2009

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions

Ladies and Gentlemen:

The global financial services practice of Paul, Hastings, Janofsky & Walker LLP represents a number of private equity firms seeking to invest in depository institutions as well as depository institutions seeking investment by private equity firms. The following comments on the Proposed Statement of Policy for Failed Bank Acquisitions (the "Proposal") by the Federal Deposit Insurance Corporation ("FDIC") reflect our recent experiences with private equity firms, from the perspective of both investors seeking to invest capital as well as institutions seeking capital. If the FDIC finalizes the Proposal, we respectfully request that the FDIC consider the various issues described below.

Executive Summary

The Proposal, if adopted as a final policy ("Final Policy"), would impose on private equity investors significant requirements, restrictions and limitations with respect to controlling and non-controlling investments in assets and liabilities from failed insured depository institutions ("Failed Banks"). In our view, the Proposal has a number of troubling aspects that likely could tilt the balance away from Failed Bank acquisitions by private equity firms and ultimately produce greater losses to the FDIC's Deposit Insurance Fund ("DIF"). It is unclear how the Proposal can be supported in light of the FDIC's statutory mandate to resolve failed and failing insured institutions at the least cost to the DIF.

In addition to the chilling effect on private equity capital -- both in the context of Failed Banks as well as capital-deficient banks -- perhaps the most notable aspect of the Proposal's potential impact is the extent to which it appears to override current laws and policies. The unilateral imposition of a 15% Tier 1 leverage ratio on banks formed to purchase assets and assume liabilities out of receivership ("Acquired Bank") is entirely inconsistent with existing capital rules and existing prompt corrective action regulatory requirements. In effect, this subjects a private equity owned bank that holds 14.9% Tier 1 capital to the same activities and other restrictions and limitations as an undercapitalized

bank that holds only 4.9% Tier 1 capital. Aside from the inequities of this approach, the merits of imposing this type of super-capital requirement are unclear.

The Proposal also strikes at the established concepts of control under the federal banking laws by subjecting an otherwise passive private equity investor to certain requirements, including a source of strength provision and cross guarantee liability, that are inconsistent with a non-controlling ownership investment. It is unclear whether a private equity investor actually could even execute a passivity agreement with its primary federal regulator where the FDIC is imposing certain expectations and ongoing obligations suggesting control by such investor.

In many respects, the Proposal also usurps the FDIC's own *de novo* policy statement[1] by establishing special rules that apply to private equity investors seeking to charter a *de novo* bank. Perhaps most important in this regard is that the FDIC has already approved a number of transactions involving private equity investments in *de novo* banks acquiring assets out of an FDIC receivership.

The retroactive application of the Proposal also draws into question, once again, the federal government's ability to abide by its end of contracts entered into with its citizens. There are a number of private equity deals that have been completed by the FDIC over the past several months of the current financial crisis, and this language certainly raises the issue about whether a Final Policy could be imposed on holding companies acquired or established by private equity investors in the last three years.

Finally, we note that the Administrative Procedure Act requires an agency that abandons its interpretation of a statute or its policies thereunder to provide a reasoned explanation for the change. *See, e.g., Motor Vehicles Mfrs. Ass'n of America* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983); *Atchison, T. & S.F.R. Co. v. Wichita Board of Trade*, 412 U.S. 800 (1973). In our view, the Proposal seeks to fundamentally change FDIC policies and requirements and standards heretofore implemented by other regulators without ever explaining why the current Congressionally-mandated systems are inadequate.[1] Specifically, the Proposal alters the fundamental relationship between the deposit insurer and the primary federal regulator. Numerous features set forth in the Proposal are clearly within the jurisdiction of the primary federal bank regulators, including the application of capital standards and PCA requirements, holding company control determinations, holding company source of strength requirements, supervision of affiliate transactions,

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[1] *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988) ("an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress."); *INS v. Chada*, 462 U.S. 919, 953, n.16 (1983) (agency action "is always subject to check by the terms of the legislation that authorized it; and if that authority is exceeded it is open to judicial review"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-14 (1976) (agency power is "not the power to make law. Rather, it is the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.") (quoting *Manhattan Gen. Equip. Co. v. Commissioner of Internal Revenue*, 297 U.S. 129, 134 (1936)).

and decisions/determinations regarding the financial and managerial resources of a private equity investor in an institution. While the FDIC may determine which entity is the winning bidder of an institution in receivership, it lacks any statutory authority to dictate terms and issues that are subject to the jurisdiction of the primary federal regulator. The Proposal implements a new paradigm for the FDIC with regard to the chartering of banks, analyzing control relationships and exercising supervisory oversight over certain matters going forward. This paradigm shift usurps Congressionally-mandated roles granted to other agencies. Adoption of a Final Policy in this form either places the FDIC in jeopardy of prolonged litigation for exceeding its statutory authority, or alternatively (and more likely) repelling new investment in the banking industry, just at a time when out-of-industry capital is most needed.

We believe that the FDIC has the opportunity to remedy the harm already done through the issuance of the Proposal by addressing the various issues discussed below.

Discussion

Confirmation of Applicability

In the month since the Proposal was issued, the willingness of private equity firms to invest in capital deficient institutions, let alone in Failed Banks, has waned significantly. Given that the ostensible target of the Proposal was investment in Failed Banks, any Final Policy should affirmatively confirm that provisions contained therein would not apply to investments in depository institutions other than in FDIC-assisted transactions. Such clarification is necessary to give assurances that traditional transactions will not be subjected to terms and conditions imposed by the Final Policy merely because transaction participants are deemed to be private equity firms.

Capital Commitment

If the FDIC issues a Final Policy, such Final Policy should revisit the appropriate level of capital to be held at institutions owned by private equity firms. As proposed, the private equity investors must agree to cause an Acquired Bank to maintain a minimum 15% Tier 1 capital leverage ratio for a period of three years, *unless* the period is *extended* by the FDIC (emphasis added); and thereafter, maintain the capital level of the Acquired Bank at no lower than "well capitalized" status during the remaining period of a private equity firm's ownership. Such requirement imposes significant risk to private equity investors who will have exceptionally high capital requirements to enter the banking industry, ongoing commitments to maintain an Acquired Bank's capital, and the risk of enforcement for a violation of a written agreement with federal banking agencies for failing to satisfy these requirements. The capital requirements also place an Acquired Bank at an extreme competitive disadvantage to ongoing banks that can operate at lower capital ratios.

We note that the FDIC already imposes higher capital requirements in connection with the formation of *de novo* institutions – requiring capital on day one equal to 8% of Tier 1 assets at the end of the third year of operations. A 15% Tier 1 ratio for an Acquired Bank's first three years of operations reflects a significantly outsized and virtually unprecedented up-front capital commitment. The impact of this requirement is further magnified when juxtaposed to the Proposal's proposed source of strength commitment and cross-guarantee requirements.

Source of Strength

Any Final Policy should eliminate the proposed source of strength requirement mandating that a private equity investor serve as a source of strength for the Acquired Bank outside of a control relationship. A source of strength requirement is inconsistent with a non-controlling investment and, in fact, could be viewed as an indicia of control by holding company regulators. Imposing a source of strength requirement could be viewed by the FRB and OTS as a potential indicia of control as it imposes ongoing requirements on shareholders beyond their initial investment.

Imposing a source of strength obligation on shareholders that do not formally control a bank is a novel and radical departure from traditional shareholder liability, as non-controlling shareholders' liability is generally limited to the amount of their investment.

Cross-Guarantee Liability

Any Final Policy should eliminate the proposed cross-guarantee obligation imposed solely on private equity firms, whereby private equity firms would be required to pledge to the FDIC their proportionate interests in each such institution to pay for any losses to the DIF resulting from the failure of, or assistance provided to, any other such institution. This requirement expands the statutorily-mandated cross-guarantee obligation for commonly controlled institutions, imposing obligations on commonly controlled banks for losses incurred by the FDIC caused by an affiliate.[2] As defined under the Federal Deposit Insurance Act, "common control" is when an institution is controlled by the same company or one depository institution controls another depository institution.[3] Finally, the statutory cross-guarantee obligation applies at the depository institution level,[4] while the Proposal appears to apply at the shareholder level. In effect, the Proposal turns such statutory mandate on its head by imposing a capital call on non-controlling shareholders of banks merely because of a perceived access to additional capital.

Pledging investors' shares to the FDIC also could violate the fundamental fund documents, which may restrict hypothecation of portfolio company shares. Cross guarantee obligations for multiple institutions also could lead to adverse consequences on private equity firms, including activities limitations if multiple private equity firms are found to be acting in concert with respect to multiple investments.

Mandatory Holding Period

Any Final Policy should shorten or eliminate the requirement that private equity firms maintain their respective investments in an Acquired Bank for at least three years, unless FDIC approval is obtained. While such holding period mitigates the possibility that an acquirer can quickly "flip" an Acquired Bank receiving FDIC assistance and reap a handsome profit – avoiding criticism that the FDIC bid process did not generate appropriate bids – the FDIC should be encouraging a vibrant free-market economy without re-sale restrictions. Implementation of this requirement of the Proposal, however, imposes new regulatory burdens and requirements for bank acquisitions. In addition to an acquirer seeking FRB or OTS approval for an acquisition, a selling entity now will be required to seek FDIC approval, a process not subject to any formal or informal timeframes.

Transactions with Affiliates Restrictions

Any Final Policy should be consistent with but not supersede the long-standing statutory framework imposed on transactions with affiliates of insured depository institutions by prohibiting extensions of credit to private equity firms, their investment funds, affiliates of either, or portfolio companies.

Barring extensions of credit by any Acquired Bank to its private equity investors, their investment funds, affiliates of either, and any companies in which the investors or affiliates invest, in effect deems a control relationship to exist and expands upon the definition of "affiliate" contained in sections 23A and 23B of the Federal Reserve Act ("FRA") and the FRB's Regulation W.[5] Rather than requiring compliance with the existing quantitative and qualitative limitations of section 23A and the market terms requirement of Section 23B of the FRA and Regulation W, which apply to all institutions and their affiliates, the Proposal prohibits an Acquired Bank from extending credit to investors, their investment funds, affiliates of either, and any companies in which the investors or affiliates invest.

This obligation creates significant compliance challenges since, if a private equity firm owns greater than 10% of a company, the Acquired Bank would be prohibited from engaging in any transactions with that company. Compliance with this requirement would require the non-controlling private equity firm to provide the Acquired Bank a likely confidential and proprietary list of its 10% or greater holdings so that the Acquired Bank would not inadvertently extend credit to a prohibited borrower.

Conclusion

Many depository institutions are facing capital challenges; some are facing capital deficiencies so great that they are likely to fail over the next few years. Without significant changes to the Proposal, a Final Policy likely would preclude meaningful participation of

private equity investors in the resolution of failing and failed institutions, thereby increasing the cost of resolutions to the FDIC and ultimately the American taxpayers. Accordingly, if the FDIC seeks to finalize the Proposal, we respectfully request that the FDIC consider the concerns discussed herein.

We are happy to discuss our comments with the FDIC or its staff. Please feel free to contact any of the following authors: V. Gerard Comizio at 202-551-1272 or vgerardcomizio@paulhastings.com; Lawrence D. Kaplan at 202-551-1829 or lawrencekaplan@paulhastings.com; or Kevin L. Petrasic at 202-551-1896 or kevinpetrasic@paulhastings.com.

Sincerely,

PAUL, HASTINGS, JANOFSKY & WALKER LLP

[1] FDIC Statement of Policy on Applications for Deposit Insurance, 63 Fed. Reg. 44756 (Aug. 20, 1998), effective Oct. 1, 1998; amended at 67 Fed. Reg. 79278 (Dec. 27, 2002), available at: http://www.fdic.gov/regulations/laws/rules/5000-3000.html#5000applicationsfd.
[2] 12 U.S.C. § 1815(e)(9).
[3] 12 U.S.C § 1815(e)(1).
[4] Pursuant to the statutory provision, "any insured depository shall be liable for any loss incurred by the [FDIC] ... in connection with the default of a commonly controlled insured depository institution." 12 U.S.C. § 1815(e)(1).
[5] *See* 12 U.S.C. §§ 371c(b)(1) and 371c-1(d)(1); *see also* 12 C.F.R. § 223.2.