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CLIENT UPDATE

FDIC Adopts Final Statement of Policy on Acquisition of Failed Banks by Private Equity Investors

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On Wednesday, August 26, 2009, the FDIC adopted a Final Statement of Policy (the "Final Statement") relating to investments by private equity firms in failed banks and other insured depository institutions. Adoption of the Final Statement followed the FDIC's publication of a Proposed Statement of Policy (the "Proposed Statement") on July 9, 2009 and extensive public comment and press regarding the restrictions and limitations that would apply to private equity investors seeking to invest in failed banks.

Although many restrictions survive in the Final Statement, the FDIC also removed or lessened certain restrictions and limitations that were contained in the Proposed Statement in response to public comment, indicating the FDIC's recognition of the need to balance the desire for long-term stability in the banking sector with the need to attract capital. It should be noted that the FDIC stated that it will review the Final Statement within 6 months following its adoption and shall make any adjustments that it deems necessary. In addition, the FDIC has retained the right to waive one or more provisions of the Final Statement on a case-by-case basis if deemed in the best interests of the goals of the Final Statement.

Application. The policies set forth in the Final Statement apply to "private investors in a company, including a company acquired to facilitate bidding on failed banks or thrifts that is proposing to, directly or indirectly (including through a shelf charter) assume deposit liabilities, or such liabilities and assets, from the resolution of a failed insured deposit institution." The FDIC declined to provide more specificity as to the types of investors covered by the policy (which had been requested by a number of commentators), stating that it found it difficult to be more precise given the number of structures used in private equity investments in banks. The FDIC did, however, clarify that the policy will not apply to (1) private equity investors who team with well-established and successful bank holding companies or (2) investors that will hold 5 percent or less of the total voting power of the acquired bank or thrift who are not acting in concert with other investors in the bank. In addition, the FDIC made provision for an application process whereby an investor in a bank that has maintained certain minimum ratings continuously for seven years, can seek to have the policy waived.

Capital Commitment. The Final Statement requires that a bank acquired or invested in by a private equity investor must maintain a Tier 1 capital ratio of common equity to total assets of at least 10 percent for three years following the investment or acquisition. Thereafter, the bank must remain "well capitalized" under current standards. The Proposed Statement had required a 15 percent Tier 1 capital ratio, but the FDIC reduced the ratio to 10 percent following significant concern and comment that a 15 percent ratio would significantly disadvantage private equity investors relative to strategic acquirers, make it difficult to earn reasonable returns on investment and encourage high-risk post-investment strategies. Although the FDIC acknowledged that the average Tier 1 capitalization requirements range from 5 to 7 percent currently, it was unwilling to go below 10 percent due to the higher risk profile it perceives in what are effectively *de novo* institutions being acquired.

Cross Support. Investors holding 80 percent or more of two or more banks will need to pledge the shares of such banks owned by them to the FDIC to collateralize any losses realized by the FDIC in any of such banks. The Proposed Statement had required such cross support in cases where private equity investors would hold a majority position in more than one failed bank, but the FDIC raised the threshold to 80 percent after considering substantial comments on the proposed cross support requirement. In addition, the FDIC received substantial comment and concern reacting to a requirement in the Proposed Statement that private equity investors would need to show that they would be a "source of strength" for a bank and that they could be required to raise additional capital for banks needing further cash infusion. Noting these concerns and the capital requirements discussed above, the FDIC opted not to include the "source of strength" requirement in the Final Statement.

Continuity of Ownership. As was the case in the Proposed Statement, the Final Statement prohibits private equity investors from selling or otherwise transferring their interests in a bank for a three-year period unless FDIC approval is obtained. Although the FDIC received comments stating that this requirement could substantially dampen interest of private equity investors in making bank investments, the FDIC noted there were also a number of comment letters supporting the holding period as reasonable taking into account that banks will need time to turn things around as well as a period of stability and commitment of management. The Final Statement does provide that FDIC approval will not be unreasonably withheld with respect to transfers within the three-year period to affiliates who agree to be bound by the terms of the Final Statement.

Other Requirements. In addition to the above, the Final Statement contains certain other restrictions that were included in the Proposed Statement prohibiting acquired banks from making loans to their private equity investors (or funds or other affiliates of such private equity investors), prohibiting the use of multiple investment vehicles or other complex structures in which beneficial ownership and control are not clearly ascertainable or where control and beneficial ownership are separated, and prohibiting the use of investment vehicles domiciled in jurisdictions applying bank secrecy laws that would limit United States bank regulators from

determining compliance with United States laws or from obtaining information regarding the competence, experience or financial condition of applicants and their related parties.

If you have any questions relating to the foregoing please contact your primary attorney at Morrison Cohen LLP or any of the following:

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