



# Regulatory Practice Letter

ADVISORY

RPL Number 09-33

## FDIC Statement of Policy on Qualifications for Failed Bank Acquisitions

### Executive Summary

The Federal Deposit Insurance Corporation ("FDIC") issued its final *Statement of Policy on Qualifications for Failed Bank Acquisitions* ("Statement") on August 26, 2009. The Statement provides guidance to private capital investors regarding the terms and conditions for bidder eligibility applicable to acquisitions of, or investments in, failed insured depository institutions. Areas addressed by the Statement include:

- Applicability;
- Capital commitment;
- Cross support;
- Transactions with affiliates;
- Secrecy law jurisdictions;
- Continuity of ownership;
- Prohibited structures;
- Special owner bid limitations; and
- Disclosure,

The FDIC notes that it will review the operation and impact of the Statement within 6 months of its approval date (August 26, 2009) and make adjustments as it deems necessary.

### Background

The FDIC approved a proposed *Statement of Policy on Qualifications for Failed Bank Acquisitions* ("Proposed Statement") on July 2, 2009. With the release, the FDIC stated that it was "particularly concerned that owners of banks and thrifts, whether they are individuals, partnerships, limited liability companies, or corporations, have the experience, competence, and willingness to run the bank in a prudent manner, and accept the responsibility to support their banks when they face difficulties and protect them from insider transactions."

The FDIC noted that the areas of the Proposed Statement generating the most comment included the capital commitment, cross support guarantees and a requirement for investors to serve as a source of strength for the acquired insured depository institution. Based on the comments received, revisions were made to each of these three areas in the final Statement.

### Subject:

**Statement of policy on qualifications for private capital investors seeking to acquire or invest in failed depository institutions.**

### As Issued By:

**Federal Deposit Insurance Corporation**

### Date:

**September 3, 2009**

## Description

### Applicability

The Statement applies prospectively to acquisitions of failed depository institutions that are completed after the approval date (August 26, 2009) by "Investors" who are defined as:

- Private investors in a company, including any 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 depository institution; and
- Applicants for insurance in the case of *de novo* charters issued in connection with the resolution of failed insured depository institutions.

The Statement does not apply to Investors that are invested in:

- A bank or thrift, or bank or thrift holding company, where the bank or thrift has maintained a composite Camels 1 or 2 rating continuously for seven years (subject to approval by the FDIC);
- Partnerships or similar ventures with bank or thrift holding companies or in such holding companies (excluding shell holding companies) where the holding company has a strong majority interest in the resulting bank or thrift and an established record for successful operation of insured banks or thrifts; or
- Five (5) percent or less of the total voting power of an acquired depository institution or its bank or thrift holding company provided there is no evidence of concerted action by these Investors.

### Capital Commitment

The resulting depository institution will be required to maintain a ratio of Tier 1 common equity to total assets of at least 10 percent for a period of three years from the date of acquisition. Thereafter, the resulting depository institution must remain "well capitalized" for as long as it is owned by the Investors. Failure to maintain either the 10 percent Tier 1 common equity to total assets ratio or the "well capitalized" status, as appropriate, would result in treatment as an "undercapitalized" institution for purposes of Prompt Corrective Action.

The Proposed Statement would have required the insured depository institution to maintain a Tier 1 Leverage ratio of 15 percent for a period of three years with the authority to extend this requirement for an additional three years. The requirement for Investors to serve as a source of strength to the institutions was eliminated.

### Cross Support

Where one or more Investors own 80 percent or more of two or more banks or thrifts, the stock of the banks or thrifts commonly owned by these Investors must be pledged to the FDIC. If any one of those depository institutions fails, the FDIC may exercise the pledges to the extent necessary to recoup any losses incurred by the FDIC as a result of the bank or thrift failure. The FDIC may waive this pledge requirement where the exercise of the pledge would not result in a decrease in the cost of the bank or thrift failure to the Deposit Insurance Fund.

The Proposed Statement would have required Investors who owned a majority interest in more than one

insured depository institution to pledge their investment to the FDIC.

### Transactions with Affiliates

The resulting insured depository institution would be prohibited from making any extensions of credit to the Investors, their investment funds, or the affiliates of either of them. However, extensions of credit by the insured depository institution to the Investors that existed at the time of acquisition would be exempt from this prohibition.

The Statement adds a requirement for Investors to provide regular reports to the insured depository institution identifying all of their affiliates. An "affiliate" is defined as any company in which the Investor owns, directly or indirectly, at least 10 percent of the equity and has maintained such ownership for at least 30 days.

### Secrecy Law Jurisdictions

Investors using ownership structures that include entities domiciled in bank secrecy jurisdictions will not be eligible to own a direct or indirect interest in an insured depository institution unless the Investors are subsidiaries of companies that are subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board. The Investors must also:

- Execute agreements on the provision of information to the primary federal regulator about the non-domestic entities' operations and activities;
- Maintain their business books and records (or a duplicate) in the U.S.;
- Consent to the disclosure of information that might be covered by confidentiality or privacy laws and agree to cooperate with the FDIC, if necessary, in obtaining

information maintained by foreign government entities;

- Consent to jurisdiction and designation of an agent for service of process; and
- Consent to be bound by the statutes and regulations administered by the appropriate U.S. federal banking agencies.

A “Secrecy Law Jurisdiction” is defined as a country that applies a bank secrecy law that limits U.S. bank regulators from determining compliance with U.S. laws or prevents them from obtaining information on the competence, experience and financial condition of applicants and related parties, lacks authorization for exchange of information with U.S. regulatory authorities, does not provide for a minimum standard of transparency for financial activities, or permits off shore companies to operate shell companies without substantial activities within the host country.

#### Continuity of Ownership

Investors covered by the Statement are prohibited from selling or otherwise transferring their ownership interest for a period of three years after the acquisition date. However, the FDIC may give approval for such a transfer prior to the expiration of the three years in certain circumstances, and notes that such approval will not be unreasonably withheld for transfers to affiliates, provided the affiliate agrees to the terms and conditions in the Statement.

The continuity of ownership provisions do not apply to mutual funds defined as an open-ended investment company registered under *the Investment Company Act of 1940* that issues

redeemable securities that allow investors to redeem on demand.

#### Prohibited Structures

Ownership structures in which the beneficial ownership is difficult to ascertain with certainty, the responsible parties for making decisions are not clearly identified, and ownership and control are separated, would not be approved for ownership of insured depository institutions.

#### Special Owner Bid Limitation

Investors that directly or indirectly hold 10 percent or more of the equity of a bank or thrift in receivership will not be eligible to be a bidder to become an investor in the deposit liabilities, or both the deposit liabilities and assets, of that failed depository institution.

#### Disclosure

Investors covered by the Statement are expected to submit information to the FDIC about the Investors and all entities in the ownership chain, including such information as the size of the capital fund or funds, its diversification, the return profile, the marketing documents, the management team, the business model and any other information determined by the FDIC to be necessary. Confidential business information provided will be treated as confidential and will not be disclosed except in accordance with law.

#### Limitations

The requirements of the Statement are separate from and in addition to any requirements set by an insured depository institution’s primary federal regulator or its bank or thrift holding company regulator. In addition, the FDIC may waive one or more provisions of the Statement if it determines such

exemption is in the best interest of the Deposit Insurance Fund and the goals and objectives of the Statement can be accomplished by other means.

### **KPMG Commentary**

The FDIC acknowledges that it is “keenly aware” of the need for additional capital in the banking system and the contribution that private equity investors could make in helping to meet this need provided the contribution is consistent with basic concepts applicable to depository institution ownership contained in banking laws and regulations. This need is dramatically highlighted by the FDIC’s Quarterly Banking Profile for the second quarter of 2009, which notes that more than 400 insured depository institutions are on the FDIC’s “problem list,” representing an increase of more than 100 institutions from the first quarter numbers. So far, eighty-four institutions have failed during 2009.

The FDIC perceives the enumerated conditions and especially the heightened capital requirement as important safeguards to ensuring that newly acquired failed depository institutions will remain healthy. The FDIC states that depository institutions insured less than 7 years are overrepresented in the list of institutions that have failed in 2008 and 2009 with most of the failures occurring between the fourth and seventh years of operation, particularly where they have pursued early changes in business plans and inadequate controls and risk management practices.

The conditions that have been put into place with this policy will have a measured impact on the appetite for private investors to acquire the assets

and liabilities of failed depository institutions. However, the impact is significantly less than originally proposed and indicates that the FDIC wants to encourage this group of potential acquirers more than might have originally seemed to be the case.

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