FDIC Issues FAQs on Statement of Policy Relating to Acquisitions of Failed Banks

On January 6, the Federal Deposit Insurance Corporation (FDIC) issued a series of "Frequently Asked Questions" on the FDIC's recent Statement of Policy on Qualifications for Failed Bank Acquisitions. Please refer to the Ropes & Gray Alert dated August 27, 2009 for a brief summary of the Statement of Policy. The FAQs signal a slightly increased willingness by the FDIC to permit private investors to invest in failed institutions, subject to the limitations of the Statement of Policy.

The Statement of Policy imposes stringent eligibility requirements unique to ownership structures in which private investors seeking to acquire failed institutions from the FDIC are not in partnership with an existing depository institution holding company that will hold a "strong majority interest" in the target institution. According to the FAQs, the FDIC has defined a "strong majority interest" to mean ownership structures in which an established bank or thrift holding company in a venture with private investors will hold at least two-thirds of the total equity and voting equity of the venture post acquisition of a failed bank or thrift from an FDIC receivership. The FAQs further provide that if private investors make their investment directly in an established bank or thrift holding company rather than through a partnership or venture structure, the Statement of Policy will not apply provided the shareholders in the bank or thrift holding company pre-dating the proposed acquisition have at least two-thirds of the total equity of the resulting bank or thrift company. The FDIC will take into account the impact of any special rights provided to private investors in these ownership structures through covenants, agreements, special voting rights, or other mechanisms in determining whether the Statement of Policy applies to such structures.

The Statement of Policy does not apply to investors who acquire five % or less of the total voting power in a bank or thrift provided they are not acting in concert with other investors. For example, participation in a widespread offering is not generally considered to be evidence of concerted action. On the positive side, the FAQs confirm that non-voting equity interests that are not convertible to voting shares at any time or are convertible only upon transfer to an unaffiliated third party will not be aggregated with voting securities for purposes of determining if the Statement of Policy applies.

Investors seeking to avoid the application of the Statement of Policy to an acquisition by amassing a group of investors each holding less than 5% of the total equity of a venture will be disappointed. The FAQs express the FDIC's concern with ownership structures in which all or substantially all of the investors own less than 5% of the voting stock, resulting in neither the investor nor the applicable depository institution being subject to the Policy. Accordingly, the FDIC will presume concerted action among investors in ownership structures in which investors who individually own less than 5% of the voting stock but collectively hold more than two-thirds of the total voting power. This presumption may be rebutted if sufficient evidence is provided that the investors are not participating in concerted action. The FAQs include a list of factors the FDIC will consider in evaluating whether this presumption has been rebutted, including the applicable primary federal banking regulator's evaluation of whether the investors are acting in concert for purposes of applying the Bank Holding Company Act and the Change of Bank Control Act. Becoming subject to FDIC scrutiny in the bid process is enough to dissuade many private investors from participating. Private investors, many of whom take very seriously the "private" aspect of their

operations, will not welcome the issuance of this new license to probe into the backgrounds and ownership structures of small investors, all of whom could purchase less than 5% of a bank that has not failed without government scrutiny.

This apparent preference for ownership structures with at least some investors holding more than 5% of the total equity suggests additional interest by the FDIC in attracting certain private investors to failed institutions, so long as they are willing to meet the Statement of Policy's heightened qualifications. However, private equity investors that are not already bank holding companies and who do not want to become one merely as a result of participating in the acquisition of a failed bank through a venture will remain challenged to structure investments in which there are one or two lead investors that together would own more than a third of the voting power, but are not acting in concert.

Private equity sponsors interested in bidding for failed banks or thrifts should carefully review the Statement of Policy, the FAQs, and the Federal Reserve Board's policies on non-controlling investors to determine whether such investments are feasible from both an economic and compliance perspective in light of the qualifications in the Statement of Policy.

If you would like further information, please contact the Ropes & Gray attorney who usually advises you.