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

The Federal Deposit Insurance Corp. (FDIC) has issued further interpretive guidance on its Statement of Policy Relating to Acquisitions of Failed Banks. The FDIC adopted the Statement of Policy last year, putting in place stringent eligibility requirements unique to ownership structures in which investors seeking to acquire failed banks and thrifts from the FDIC do not partner with an established bank to acquire the failed bank or thrift. Responding to the requirements of the original Statement of Policy, investors have sought to develop efficient upstream capital delivery structures and strategies to fund failed bank acquisitions. Having reviewed more than a few new approaches, the FDIC has clarified its position on some of the new structures that can fairly be viewed as continuing to discourage the flow of capital into failed bank acquisitions.

FDIC Will Scrutinize Recaps Designed to Avoid Statement of Policy

The Statement of Policy does not apply to acquisitions of failed banks where an established bank, in partnership with private investors, holds a "strong majority interest" in the joint venture or target failed bank and the established bank has a record of successfully operating depository institutions. The FDIC defines a "strong majority interest" to mean ownership structures in which an established depository institution will hold at least two-thirds of the total equity and voting equity of the acquired failed bank. Investors have sought to satisfy the strong majority interest requirement by investing in established banks, which can then be used as a platform for acquiring failed banks without being subject to the Statement of Policy. In contrast, an investor who directly acquires a 5% or greater voting interest in a failed bank in receivership would be subject to the Statement of Policy, including the obligation to hold the investment for a minimum of three years.

In a recent set of FAQs, the FDIC made clear that there is no requirement that investors must hold their ownership interests in an established bank for any specific amount of time prior to a proposed acquisition of a failed bank or thrift. However, the FDIC will take into consideration whether a significant portion of the total equity shares or voting equity shares held by investors in the established bank prior to the acquisition of a failed bank or thrift was recently acquired or was part of a recap of the established bank. In particular, where investors recapitalize an institution that then seeks to acquire a failing bank, the FDIC will review the timing and purpose of the recap, including whether the additional capital was conditioned on completion of failing bank acquisitions, and the number of failed bank acquisitions following the recap. The FDIC made clear that the Statement of Policy will apply if any acquisition of one or more failed banks occurs that in combination exceeds 100% of the recapitalized institution's total assets within an 18-month period after the recap.

Investors Holding One-Third of Total Voting Shares Must Be Bound by the Statement of Policy

The most recent FAQs also clarify that private investors who collectively hold one-third of the total voting equity share or total equity shares of a failed bank must be subject to the Statement of Policy. This "1/3 test" needs to be met at the time of the failed bank acquisition through a so-called "anchor group" of investors. This group must consist of investors who individually hold more than 5% of the total voting power and who must comply with the Statement of Policy, and any other investors who agree to comply with the Statement of Policy in order to meet the 1/3 test. Investors subject to the Statement of Policy are prohibited from selling or otherwise transferring their securities for three years from acquisition, absent FDIC approval. This requirement means that private investors who wish to avoid being subject to the Statement of Policy will need to structure investments with larger investor groups, which increases complexity, expense, and likely attracts greater scrutiny from the FDIC.

Secrecy Law Jurisdiction Requirements

The FDIC also confirmed that it will consider investors who are domiciled in non-U.S. jurisdictions to be in compliance with the Statement of Policy's requirements relating to investors organized in "Secrecy Law Jurisdictions" if the offshore investor makes its investment in a failed bank through at least one wholly-owned U.S. domiciled subsidiary. The subsidiary must (i) maintain an office in the United States, (ii) maintain its books and records and an "exact duplicate" of the offshore investor's books and records, in such office, (iii) maintain a current list of all investors in the offshore investor, and (iv) make the foregoing information available to the FDIC upon request. These conditions are similar to the Federal Reserve's requirement that investors domiciled in non-U.S. jurisdictions execute passivity commitment letters that require the investor to agree to be subject to the jurisdiction of the U.S. courts and maintain its books and records with an agent located in the United States.

The investors seeking to invest in failed banks will continue to face increased scrutiny and suspicion from the FDIC. Additionally, investors seeking to make non-control investments through recapitalizations of established institutions will need to focus on the timing of their investment relative to the institution's acquisition of failed banks. An investor could become subject to the Statement of Policy merely as a result of the timing of the established institution's decision to acquire one or more failed banks.

Fund sponsors interested in bidding for failed banks 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 requirements in the Statement of Policy.

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