

January 11, 2010

Failed Bank Acquisitions

FDIC Releases Revised Frequently Asked Questions on the Statement of Policy on Qualifications for Failed Bank Acquisitions

SUMMARY

On January 6, 2010, the Federal Deposit Insurance Corporation released Frequently Asked Questions (the "Revised FAQs") on its August 26, 2009 Statement of Policy on Qualifications for Failed Bank Acquisitions (the "Statement of Policy"). The FAQs replace and supersede the Frequently Asked Questions that were released by the FDIC on December 11, 2009 and subsequently withdrawn (the "Original FAQs"). The Statement of Policy was described in our Memorandum of August 28, 2009 and the Original FAQs were described in our Memorandum of December 14, 2009, both of which are located on our website at <http://www.sullcrom.com/publications/>.

The Revised FAQs make two significant changes from the guidance in the Original FAQs, both of which are of particular relevance for so-called "blind pool", "recapitalization" and similar "platform bank" arrangements to purchase failed banks. Foremost, the Revised FAQs provide that structures in which investors each ultimately own 5% or less of the voting equity will result in the investors being presumed to be acting in concert and subject to the Statement of Policy if the investors in the aggregate acquire more than two-thirds of the total voting equity of an acquired depository institution or its holding company (an "investee institution"), although this presumption can be rebutted. The Original FAQs had provided that, if each investor were limited to not more than 5% of the total voting power, the investors and the investee institution would be exempt from the limitations and restrictions of the Statement of Policy, without regard to the level of total voting equity ownership by the investors. In addition, the Revised FAQs provide that "concerted action" among investors will be determined by the FDIC based on a "facts and circumstances" analysis. Under the Original FAQs, the FDIC would generally defer to the determination of the investee institution's primary federal regulator.

SULLIVAN & CROMWELL LLP

The Revised FAQs appear to discourage “blind pool” or similar arrangements that were structured in response to the Statement of Policy. Under those structures, voting ownership by each investor was limited to 5% so that the special capital and other requirements of the Statement of Policy would not be applicable to the investors and the investee institution. The Revised FAQs introduce structural requirements to those transactions, while appearing to encourage transactions involving a combination of one or more lead investors, which are, and make the investee institution, subject to the Statement of Policy and “blind pool” investors, which are not subject to the Statement of Policy.

More fundamentally, the Revised FAQs suggest an FDIC position that the Statement of Policy should have broad application. Their effect will need to be seen in light of that FDIC policy objective.

IMPORTANT CHANGES FROM THE ORIGINAL FAQs

Application of the Statement of Policy to Certain Structures

The Statement of Policy established an exclusion for investors with 5% or less of the total voting power of an investee institution, provided there is no “evidence of concerted action” by such investors. Nonetheless, in the Revised FAQs, the FDIC states concerns with ownership structures in which all investors own 5% or less of the voting equity of an investee institution, resulting in neither the investors nor the investee institution itself being subject to the Statement of Policy. Accordingly, in these cases, the FDIC will presume concerted action among such investors if, in the aggregate, they hold more than two-thirds of the total voting equity.

The presumption of concerted action in this instance may be rebutted if the investors or a placement agent provides sufficient evidence to the FDIC that the investors are not participating in concerted action. The Revised FAQs provide a long list of the factors that the FDIC will consider in evaluating whether the presumption of concerted action has been rebutted. The factors are:

- whether each investor was among many potential investors contacted by the bank/thrift or its agent, and each investor reached an independent decision to invest in bank/thrift;
- whether an investor is managed or advised by an investment manager or investment advisor who performs the same services for another investor;
- whether the investors have engaged, or anticipate engaging, as part of a group consisting of substantially the same entities as are shareholders of the bank/thrift, in substantially the same combination of interests, in any additional banking or non-banking activities in the United States;
- whether an investor has any significant ownership interest in any other investor in the bank/thrift;
- whether an investor is entitled to acquire any other investor’s shares;
- whether there are any agreements or understandings between any of the investors for the purpose of controlling the bank/thrift;
- whether the investors (and each director representing each investor) will consult with the other investors concerning the voting of bank/thrift shares; and
- whether the directors representing the investors will represent only the particular investor which nominated him or her, and will not represent any combination of investors.

SULLIVAN & CROMWELL LLP

The application of each factor and its relative significance are not specified, and it remains to be seen how willing the FDIC will be to allow the presumption to be rebutted.

Determination of “Concerted Action”

The Original FAQs noted that the FDIC will generally defer to the determination of an investee institution’s primary federal regulator (for example, the Federal Reserve in the case of a bank holding company or the Office of Thrift Supervision in the case of a savings and loan holding company) as to whether investors are acting as “an association” or participating in a “concerted action” under applicable holding company or change in control laws. The Revised FAQs change this determination to a “facts and circumstances” analysis by the FDIC, in which the FDIC has indicated it will take into account the evaluation of the investee institution’s primary federal regulator.

In the Revised FAQs, the FDIC stated that participation in widespread offerings will not generally be considered to be evidence of concerted action by the resulting investors, but did not indicate what constitutes a “widespread offering” and did not offer further guidance regarding the FDIC’s concerted action analysis. The Revised FAQs do not contain the specific guidance in the Original FAQs that the use of a placement agent to solicit investors in a potential failed bank opportunity (provided that each investor makes its own independent decision regarding the investment) would not be in and of itself determinative of concerted action.

Implications of the Revised FAQs

In response to the Statement of Policy, a number of so-called “blind pool” or “recapitalization” arrangements had been structured to acquire failed banks without subjecting either (i) the investee institution to the Statement of Policy’s special capital requirement or (ii) the investors to the Statement of Policy’s holding period and other requirements. The Revised FAQs appear designed to favor a combination of a blind pool and one or more lead investors with the lead investors and the investee institution subject to the Statement of Policy.

These transactions generally have been structured so that no investor owns more than 5% of the voting equity of the investee institution (and many investors own much less). The Revised FAQs, however, subject the investors and investee institution to the Statement of Policy requirements unless such investors either (i) hold no more than two-thirds of the target institution’s voting stock (the “two-thirds exemption”) or (ii) are able to rebut the presumption of acting in concert.

Limiting blind pool investors to two-thirds of the investee institution’s existing voting equity (with one-third of the voting equity being retained by the existing holders) would effectively mean that the investors cannot expand the target’s capital in connection with failed bank acquisitions by more than 200%. Most of the blind pool arrangers and investors anticipate a far greater expansion level. In addition, requiring that one-third of the voting equity be retained by the existing holders presents additional challenges in a recapitalization transaction. Accordingly, usage of the two-thirds exemption will seemingly be infrequent,

SULLIVAN & CROMWELL LLP

unless coupled with investments by one or more lead investors who are willing to be subject to the Statement of Policy as described below.

The rebuttal approach imposes a measure of uncertainty and potential for a prolonged review. If the investors were deemed to be acting in concert, then each would be subject to the Statement of Policy. This may be unacceptable to many investors due to the holding period and disclosure requirements. The difficulty of obtaining information from investors about their management, strategies and structures could well impede the ability of sponsors to structure deals contemplating a rebuttal process. Moreover, particularly in view of the FDIC's apparent intention to apply the Statement of Policy widely, the outcome of the rebuttal process is uncertain. At a minimum, the potential for a long review may decrease the flexibility of investors. For example, if the target is a failing bank or entity organized to acquire one, a prolonged review process could delay the timing of a bid beyond the stated deadline.

On the other hand, many transactions anticipate an IPO within the three-year holding period. This fact could substantially mitigate concerns of investors over the effect of the Revised FAQs.

Further compounding this uncertainty is the second significant change from the Original FAQs. As mentioned, the Original FAQs provided for the FDIC generally to defer to the determination of the primary regulators. Prior determinations by those regulators offer substantial predictability. In providing that the FDIC will only "take into account" – as opposed to deferring to – the views of the primary regulator, as well as requiring a "facts and circumstances" analysis by the FDIC, the Revised FAQs suggest a substantial lessening of predictability. Thus, transaction structures could be subject to two different standards on the same concept – acting in concert.

The Revised FAQs appear to encourage a combination of a blind pool and one or more lead investors which would own at least one-third of the voting power of the investee institution, thus opening opportunities for private equity and other private capital investors to participate. The investee institution would be subject to the special capital requirement, and the lead investor(s) would be subject to the various requirements applicable to "private investors" under the Statement of Policy. The investors with voting interests of 5% or less, however, would not be subject to the private investor requirements, and the potential of a prolonged and uncertain rebuttal period would be largely eliminated. This structure should work for both a recapitalization of an existing institution or an investment in a new institution created to acquire failed banks.

As the Revised FAQs are written, it would still appear to be possible to structure a transaction that is not subject to the Statement of Policy. The structure would involve an investor not deemed a "private investor" acquiring one-third of the investee institution and blind pool investors acquiring the remainder. The term "private investor", however, remains undefined and, therefore, it remains unclear if the term is intended to apply to investors beyond traditional "private equity investors" such as pension funds, sovereign wealth funds, insurance companies and possibly wealthy individuals or families. In view of the

SULLIVAN & CROMWELL LLP

FDIC's overall approach, it would be highly desirable to review such a structure with the FDIC before initiating implementation.

The Revised FAQs also appear to leave in place the Statement of Policy's exemption for private investments in publicly-held banks and bank holding companies where the existing public shareholders retain a "substantial majority" of the voting stock.

* * *

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance and corporate transactions, significant litigation and corporate investigations, and complex regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 700 lawyers on four continents, with four offices in the U.S., including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Jennifer Rish (+1-212-558-3715; rishj@sullcrom.com) or Alison Alifano (+1-212-558-4896; alifanoa@sullcrom.com) in our New York office.

CONTACTS

New York

H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
Michael T. Escue	+1-212-558-3721	escuem@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Andrew R. Gladin	+1-212-558-4080	gladina@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Camille L. Orme	+1-212-558-3373	ormec@sullcrom.com
Donald J. Toumey	+1-212-558-4077	toumeyd@sullcrom.com
Michael M. Wiseman	+1-212-558-3846	wisemanm@sullcrom.com
Mark J. Welshimer	+1-212-558-3669	welshimerm@sullcrom.com

Washington, D.C.

Andrew S. Baer	+1-202-956-7680	baera@sullcrom.com
William F. Kroener III	+1-202-956-7095	kroenerw@sullcrom.com
J. Virgil Mattingly	+1-202-956-7028	mattinglyv@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com

Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Stanley F. Farrar	+1-310-712-6610	farrars@sullcrom.com
