

Federal Banking Regulators Adopt Shelf Approval Process to Facilitate Bidding by Private Equity Funds on Failing and Failed Depository Institutions

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The Federal Deposit Insurance Corporation (the "FDIC"), as receiver for an FDIC insured depository institution, generally conducts a bidding process and transfers the deposits and assets of the depository institution to the winning bidder. In a particular transaction, the FDIC may transfer all of the deposits or only the insured deposits; it may transfer some or all of the assets; it may transfer the deposits to one party and the assets to another; it may provide loss sharing arrangements for the assets or not; it may provide financing or not. However, in every case the deposits may be transferred only to an insured depository institution. In most such transactions, the bidding process occurs immediately prior to the FDIC stepping in as receiver for the failing depository institution and the winning bidder must be in a position to acquire, typically over a weekend, the deposits and branches of the failing depository institution. In the past, this has meant only banking organizations that already owned an insured depository institution were eligible to participate in the bidding for failed depository institutions.

The financial crisis has resulted in the failure of a number of insured depository institutions and is expected to result in the failure of many, perhaps hundreds, more. In order to increase the pool of bidders on failed and failing insured depository institutions and, in particular, to make it easier for private equity firms to participate in the bidding, the Office of the Comptroller of the Currency (the "OCC"), the FDIC and the Board of Governors of the Federal Reserve System (the "Federal Reserve") recently adopted special application procedures to enable parties that do not already own an insured depository institution to qualify as bidders. The intent is to obtain sufficient information from such potential bidders in advance of any bidding process so that they can obtain, on a conditional basis, the three approvals that are needed to be qualified to bid on failing and failed insured depository institutions: obtaining a bank charter from the OCC, obtaining deposit insurance from the FDIC, and obtaining approval to become a bank holding company from the Federal Reserve. If such a potential bidder is then selected by the FDIC to acquire a failed insured depository institution, it will be in a position to obtain, within a very short time period, final approvals from the OCC, the FDIC and the Federal Reserve.

A. THE OCC SHELF CHARTER PROCESS

The purpose of the OCC shelf charter process is to enable parties that do not have a bank charter to participate in bidding for failed or failing banks that are being sold by the FDIC. Such parties must be ready to take control of and operate an insured depository institution more or less immediately. For this reason, the OCC is not interested in taking applications for shelf charters unless the

applicants have the basic requirements for promptly making an acquisition from the FDIC: capital, identified management with experience in the banking industry, and a business plan.

With regard to capital, the OCC is interested in the amount of capital that is immediately available from an investor or group of investors to invest in FDIC transactions. The OCC does not require capital commitments in connection with granting a shelf charter, but it does want to be sure that those who receive shelf charters will in fact be in a position to immediately make significant bids on failed or failing banks.

Second, the OCC wants to be sure that prospective bidders have a management team (proposed directors and senior executive officers) in place that are experienced in banking and that the OCC can review. It is not sufficient to merely have a potential management team in mind; they must be in place. Although a bidder typically will retain some of the management of the bank being acquired, it should have its own team of key officials, which would normally include the chief executive officer, chief financial officer and chief credit officer. An important part of the shelf charter process is reviewing the proposed management and conducting the "name check" process on such management and on key executives of the private equity fund or other investor. This involves completing the Interagency Biographical and Financial Report (the "IBFR") and providing fingerprints for such persons. As this is often a time-consuming part of the application process, the regulators are willing to start this part of the conditional approval process even if other information is not yet ready for submission.

The OCC recognizes that, without knowing what it is going to acquire, a prospective bidder is not in a position to prepare a detailed business plan. However, the OCC does want to get a sense of the basic strategy that prospective bidders intend to pursue. The preliminary business plan should outline the intended product and business lines, retail branching plans, and capital, earnings and liquidity projections.

The process for obtaining a shelf charter begins with a conference call between the prospective bidder and the OCC in which the prospective bidder describes the amount of capital it intends to make available in such transactions, the proposed management team, and the business strategy that the bidder intends to pursue. Assuming that the OCC is satisfied that the prospective bidder understands the nature and purpose of the shelf charter process and is able to meet the three basic qualifications (capital, management and business plan), the bidder will then be invited to formally begin the process by submitting a charter application, the IBFRs, fingerprints, etc. Essentially, the prospective bidder should prepare as much of the standard application form as is feasible, given the fact that the bidder does not know the nature or size of failing institution that it actually will acquire. The focus should be on capital, management and the business plan. After the OCC has reviewed and is satisfied with the application, it will issue a conditional preliminary approval to the charter application and the applicant will be permitted to establish the corporate existence of the bank and begin organizing it to commence business. However, it is not yet permitted to actually engage in the banking business.

When the owners of the shelf charter identify a target that is being offered by the FDIC, they are required to notify the OCC and submit a detailed "Acquisition Business Plan" setting out the bank's plans for the initial capitalization, operations, and business of the acquired institution, with a particular focus on the first few weeks after the acquisition.¹ After the OCC indicates that it has no objection, the bank may proceed to submit a bid to the FDIC.

B. FDIC INSURANCE

The OCC shelf charter process contemplates that the investor group that receives the shelf charter will promptly, or simultaneously, seek deposit insurance from the FDIC. A bank cannot acquire insured deposits from the FDIC as receiver unless the bank has been approved to offer FDIC insured deposits. The process of getting FDIC insurance is normally lengthy. On November 26, 2008, the FDIC issued a press release describing a process for parties that do not have a bank charter to obtain pre-clearance to participate in the bidding for failing and failed banks. The modified deposit insurance application process is available only to those that wish to acquire deposits of failing banks and that have received conditional approval for a charter from the OCC or another chartering authority. The FDIC press release does not spell out the proposed process in detail, but it does contemplate "abbreviated information submissions and applications and the conditional approval of deposit insurance in order to qualify interested parties for the FDIC's failing institution bidders list". As with the OCC, the focus in such submissions will be on a summary business plan, readily available capital and an identified management team that is subject to financial and biographical review.

C. FEDERAL RESERVE PRE-CLEARANCE

Private equity funds that are expected to take advantage of the expedited processes for obtaining a charter and FDIC insurance generally do not want their fund groups to be subject to the activity restrictions, supervision and capital requirements that are imposed on bank holding companies. Typically, they will form a consortium of like minded investors, each of which will make a noncontrolling investment in a company that would become a bank holding company upon acquiring a charter and completing an acquisition transaction with the FDIC. Alternatively, a private equity fund may establish a "silo" structure that is sufficiently separate from the rest of the private equity group that the entities in the silo can become bank holding companies without causing the rest of the group to become subject to the Bank Holding Company Act. In either case, private equity investors that do not have a bank charter and that are acquiring one in order bid on transactions with the FDIC will need to reach agreement with the Federal Reserve as to which entities do and do not need to file register as bank holding companies.

¹ See Appendix A to the OCC's November 17, 2008 letter to Ms. Carla J. Brooks, which was the OCC's first shelf charter approval letter and which is available on the OCC web site.

The Federal Reserve cannot provide formal Bank Holding Company Act approval prior to the time that a prospective bidder actually acquires a bank (whether it be a failed bank or a shelf charter that has become an active bank in connection with an acquisition of deposits from the FDIC as receiver), but, as in the OCC shelf charter and the FDIC conditional approval of deposit insurance, the Federal Reserve can and will accept information from private equity and other potential investors and complete enough of the bank holding company application process so that the Federal Reserve can assure the FDIC that the rest of the process could be completed promptly if the investors were awarded a bid from the FDIC.

In addition to reviewing the structure of the proposed transaction to ensure that there is agreement on which entity or entities will become bank holding companies, the Federal Reserve will want to review a preliminary business plan for the proposed holding company. While such a business plan is necessarily missing much of the detail that will be available only when a bid is actually won, the Federal Reserve will want to get a sense of the amount of capital the investors are planning to invest, the size of the potential targets, whether they will be troubled or failed, etc.

Finally, the Federal Reserve will review IBFRs and fingerprints for the proposed directors and executive officers of the bank holding company and, at least where the private equity fund or other proposed investor is dominated by one or a few persons, for those persons.

D. CONCLUSION

The pre-clearance process described above has been established for a specific purpose: to enable potential bidders on failing or failed banks who do not currently own an insured depository institution to qualify to participate in the bidding process. The process is not intended as a short cut to entering the banking business (other than through the acquisition of deposits from the FDIC as receiver). For this reason, private equity funds that propose the acquisition of only a very small failed bank are likely to get less attention from the regulators.

Nor does the pre-clearance process result in a final approval. An applicant that completes the pre-clearance process and that is awarded a bid by the FDIC must still complete the OCC charter process, the FDIC deposit insurance process and the Bank Holding Company Act approval process. However, the applicant will be in a position to complete those processes quickly.

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