COMMITTEE ON CAPITAL MARKETS REGULATION

August 9, 2009

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions

Dear Mr. Feldman:

Since 2005, the Committee on Capital Markets Regulation ("Committee") has been dedicated to improving the regulation of U.S. capital markets. Our research has provided an independent and empirical foundation for public policy. Most recently, in May 2009, the Committee released a comprehensive report entitled *The Global Financial Crisis: A Plan for Regulatory Reform* ("Report"), which contains 57 recommendations for making the U.S. financial regulatory structure more integrated, more effective, and more protective of investors. Because our Report addresses private equity investments in banks and thrifts as well as regulatory capital requirements, we believe it useful to comment on the FDIC's recent Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions.

Since the outset of the global financial crisis, U.S. banks and thrifts have been in desperate need of capital. The federal government has attempted to meet this need by injection of capital at considerable risk to taxpayers. Given the need for more capital and the strong preference for private rather than public capital, the Committee supports measures that would enhance—rather than impede—the ability of private equity firms to acquire depository institutions. Moreover, the private equity management model, which more closely aligns the interests of managers and shareholders, may bring needed management skill to the depository sector. Indeed, these points arguably apply with even greater force to already-insolvent depositories which are placed under the FDIC's control and are potential liabilities to the Nation's deposit insurance fund. The resources of the deposit insurance fund and the exposure of the taxpayer can best be protected by disposing of failed banks to the private sector as early as is reasonably possible.

We believe the chief features of the FDIC's proposed policy could discourage private equity firms from investing in depositories—a result that could have a significant and adverse effect on the financial system. At the center of the proposed policy is a requirement that private capital investors maintain a 15% leverage ratio for at least three years following the purchase of a bank or thrift from the FDIC. We would counsel against imposing that requirement. In our Report, we acknowledge that the leverage ratio is an important safeguard and even recommend that it should be strengthened as a backstop to Basel II. But we equally believe it should be strengthened across-the-board; it should not vary depending on who is acquiring a depository, nor on whether the depository is or is not being acquired. Even if the leverage ratio is strengthened across-the-board, a 15% ratio appears rather high—indeed three times higher than the current 5% ratio for well-capitalized banks. Absent further analysis by the FDIC laying out an objective basis for the proposed 15% ratio, we cannot endorse this requirement. In addition, we also recommended in our Report careful consideration of whether the leverage ratio should be recalibrated in terms of tangible common equity rather than Tier I capital, as presently formulated. We thus encourage the FDIC to do so here and, once again, recommend that any change to the leverage ratio be made across-the-board.

Furthermore, we are concerned that other aspects of the FDIC's proposed policy could discourage investments in depositories critically in need of capital. Of particular concern is the proposed application of the "source of strength" doctrine to private equity investors. We do not believe management companies or their investors need to serve as a source of strength for the depositories. The efficacy of this policy has been disputed even in normal times. But in the midst of this crisis, it could be counterproductive to burden investors willing to take a chance on rehabilitating a failed depository with an open-ended commitment.

To the extent there is a source of strength requirement, we believe it should be applied selectively and only to the banking silo of a given private fund complex. Some may contend that a holding company established by private investors may lack the capital base of a more traditional purchaser of failed banks (namely, an existing banking organization) and therefore argue that higher capital requirements (such as the 15% leverage ratio proposed above) are warranted for the bank to compensate for the lack of a source of strength. The best private equity can do is to promise to raise capital in the future if it becomes necessary. However, dependable contingent access to capital in the future, rather than holding excess capital in the present, might be a better overall approach to capital for all institutions.[*] As stated above, if the capital requirements are to be higher for private equity owned banks, due to source of strength concerns, there should be objective analysis to support the extent of such higher requirements.

A related measure contained in the FDIC's proposed policy is the requirement that one bank guarantee another bank's liabilities if the two banks share a certain number of private investors in common. We believe this could have similarly negative effects, and is an inappropriate importation of the requirement designed for two wholly-owned subsidiaries of the same bank financial holding company. In the private equity context, the two banks are unlikely to have identical ownership structures and the proposed policy itself purports to cover overlapping but not identical groups of investors. The potential for a cross guarantee would likely dissuade potential investors from participating in a syndicate purchasing a failed bank that belonged to a multiple bank private equity structure. We are further concerned that, if adopted, the requirement could increase systemic risk by multiplying the degree of interconnectedness among depositories.

We understand that the FDIC has legitimate concerns about the ownership of depositories by private firms whose investment portfolios extend beyond banks and thrifts and, in many

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[*] See The Committee on Capital Markets Regulation, *The Global Financial Crisis: A Plan for Regulatory Reform* 68-69 (May 2009) (discussing the possibility of a contingent capital requirement).

cases, beyond the financial sector altogether. But rather than prevent private capital from revitalizing once-failed depositories we believe the commercial activities of the private firms can be adequately separated from the depositories so that there is no real threat of mixing the two businesses.

Thank you for considering our comments. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

Respectfully submitted,

R. Glenn Hubbard	John L. Thornton	Hal S. Scott
CO-CHAIR	CO-CHAIR	DIRECTOR

cc: Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation
Martin J. Gruenberg, Vice Chairman, Federal Deposit Insurance Corporation
Thomas J. Curry, Director, Federal Deposit Insurance Corporation
John C. Dugan, Comptroller of the Currency
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