

## 2009 DEVELOPMENTS IN FDIC FAILED BANK RESOLUTIONS

By

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During the first nine months of 2009, the condition of the U.S. banking industry continued to put severe strains on the capacity of the Federal Deposit Insurance Corporation (FDIC) to cope with failed and failing institutions. This has compelled the FDIC to continue to innovate in order to streamline its receivership operations and reduce costs.

Numbers tell the story. From December 31, 2008 to June 30, 2009, banks and thrifts on the agency's watch list increased from 252 to 416, the largest number since 1994. Total assets of those 416 institutions were \$299.8 billion, the largest amount on the watch list since 1993. The FDIC's Deposit Insurance Fund (DIF), its principal unallocated source of funds to finance receiverships and conservatorships, declined to \$10.4 billion, or 0.22% of insured deposits, the lowest percentage coverage in more than 16 years.<sup>1</sup> Forty-five institutions failed in the first half of 2009, compared to four in the first half of 2008. Twenty-one institutions failed in the second half of 2008, but during the third quarter of 2009 alone an additional 45 institutions were closed, including the sixth and eleventh largest institutions ever to fail, at an estimated total cost to the DIF of \$14.8 billion.<sup>2</sup> On nine occasions during the first nine months of 2009, no bank or thrift could be found to assume the deposits of a failed institution on acceptable terms, requiring the FDIC to establish a Deposit Insurance National Bank to assume deposits, create a bridge bank or make a direct pay-out to depositors of the insured amount of their accounts.<sup>3</sup>

The ability of the banking industry to absorb losses also has been taxed, which foretells continuing pressure on the DIF. In the second quarter of 2009, the industry posted a net loss of \$3.7 billion, only the second quarterly loss since 1991. Factors contributing to the loss included net charge-offs of \$48.9 billion, the largest quarterly charge-offs in dollars and as a percentage of total loans on record. Noncurrent loans and leases increased for the 13th consecutive quarter and also set a record in dollar amount and as a percentage of total loans and leases. The ratio of loan loss reserves to total loans and leases rose to a new high of 2.77%, but

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<sup>1</sup> FDIC Quarterly Banking Profile, Second Quarter 2009 ("QBP"), available at [www.fdic.gov/qbp/2009jun/qbp.pdf](http://www.fdic.gov/qbp/2009jun/qbp.pdf).

<sup>2</sup> FDIC Failed Bank List, available at [www.fdic.gov/bank/individual/failed/banklist.html](http://www.fdic.gov/bank/individual/failed/banklist.html); FDIC Press Release PR-143-2009 (Colonial Bank, Montgomery, Alabama) (Aug. 14, 2009); FDIC Press Release PR-150-2009 (Guaranty Bank, Austin, Texas) (Aug. 21, 2009); CNN Money, "Third Largest Bank Failure of 2009 Announced," available at [www.money.cnn.com](http://www.money.cnn.com) (last updated Aug. 21, 2009).

<sup>3</sup> FDIC Failed Bank List.

the ratio of such reserves to noncurrent loans fell to 63.5%, the lowest level since September 30, 1991.<sup>4</sup>

In the face of these conditions, the traditional methods of the FDIC to resolve a failed bank—sell the deposits, retain and manage a majority of the assets and dispose of those assets over time—have evolved. The FDIC is now pursuing four principal resolution strategies: loss sharing transactions with strategic buyers; loss sharing transactions with joint ventures between strategic buyers and private equity investors (PE Investors); transactions with PE Investors that acquire a shelf charter and can tolerate the restrictions established by the FDIC’s new Statement of Policy on Qualifications for Failed Bank Acquisitions (SOP);<sup>5</sup> and most recently, split or “good bank/bad bank” transactions in which a strategic buyer acquires the deposit franchise and an eligible investor acquires the assets through a private placement of an interest in a structured investment, such as the announced Corus transaction.<sup>6</sup>

### Loss Sharing Transactions

During 2008, only three of the 25 institutions that failed were resolved in transactions in which the FDIC agreed to share a portion of the losses on the assets purchased by the acquiring institution.<sup>7</sup> During the first nine months of 2009, the FDIC entered into loss sharing transactions for 56 of the 95 institutions that failed.<sup>8</sup> Loss sharing transactions accounted for \$74.6 billion out of \$138.7 billion, or 54%, of the assets of all the institutions that failed during that period. In the loss sharing transactions for which the FDIC reported the information, the loss sharing covered \$55.7 billion, or 75%, of the total assets purchased by the acquirers of those institutions.<sup>9</sup>

Loss sharing has clearly become a standard part of the FDIC’s resolution arsenal. In some cases, loss sharing may be the only means to interest bidders in the toxic assets of a failed bank or thrift.<sup>10</sup> However, even when the FDIC is disposing of healthier assets, loss sharing has several advantages for the agency. The FDIC can reduce substantially and in some cases eliminate entirely the front-end cost of a receivership, which it incurs when it must pay cash to an acquiring institution in lieu of transferring the assets of the failed institution. Similarly, the agency can reduce the manpower, overhead and outsourcing required to manage retained assets.<sup>11</sup> Finally, it can keep the majority of the assets of failed institutions in the private sector,

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<sup>4</sup> QBP, at 1-2.

<sup>5</sup> Final Statement of Policy on Qualifications for Failed Bank Acquisitions, 74 Fed. Reg. 45440 (Sept. 2, 2009).

<sup>6</sup> FDIC Press Release PR-168-2009 (Corus Bank, N.A., Chicago, Illinois) (Sept. 11, 2009).

<sup>7</sup> FDIC Press Release PR-56-2008 (IndyMac Bank, F.S.B., Pasadena, California) (July 11, 2008); FDIC Press Release PR-124-2008 (Downey Savings & Loan Association, F.A., Newport Beach, California and PFF Bank & Trust, Pomona, California) (Nov. 21, 2008). In addition, the FDIC facilitated the acquisition of all the assets of Washington Mutual Bank, Henderson, Nevada, and Washington Mutual Bank, FSB, Park City, Utah, by JPMorgan Chase Bank, N.A. (FDIC Press Release PR-85-2008 (Sept. 25, 2008)).

<sup>8</sup> Since May 22, 2009, loss sharing occurred in 45 of the 62 bank closings; only nine of the 62 bank closings represented traditional purchase and assumption transactions. See FDIC Failed Bank List.

<sup>9</sup> *Id.*

<sup>10</sup> *But see* Matthew Monks, *Midsized Players Passing on Further Failure Deals*, AMERICAN BANKER, Sept. 23, 2009, at 1, discussing reluctance of large regional banks to engage in FDIC-assisted transactions.

<sup>11</sup> For the second quarter of 2009, the chief financial officer of the FDIC reported that expenses for receivership operations were substantially under budget, primarily because of the prevalence of structured

where those assets will presumably retain a higher value and minimize the impairment in value of comparable assets on the books of open institutions.

A typical loss sharing arrangement covers an identified portfolio of home mortgage loans, other loans and, in certain instances, asset-backed securities of the failed bank. The losses (and recoveries) on those assets are handled in three tranches. Losses in the first tranche are absorbed entirely by the acquirer. However, the size of the first tranche is determined by a formula that takes into account any premium or discount in the price of the assets, any premium or discount in the price of the assumed deposits and any deficiency between the value of the non-cash assets and the assumed deposits.<sup>12</sup> Under this formula, in certain cases in which the assets are acquired at a significant discount or the value of the non-cash assets is less than the amount of the assumed deposits, the first tranche may be entirely eliminated.<sup>13</sup> Losses in the second tranche, which covers all losses up to a stated threshold amount, are shared 80% by the FDIC and 20% by the acquirer.<sup>14</sup> Losses in the third tranche, which covers all losses above the threshold, are typically shared 95% by the FDIC and 5% by the acquirer.<sup>15</sup>

In the view of the FDIC, this type of loss sharing arrangement sufficiently aligns the financial incentives of the FDIC and the acquirer to ensure that the covered assets will be managed effectively and in a manner that will contribute to a least-cost resolution by the FDIC.<sup>16</sup>

## Joint Ventures

A loss sharing arrangement as described above is equally attractive to PE Investors and strategic buyers (established banking organizations), but the FDIC appears to have grown wary of dealing with PE Investors in loss sharing transactions. In two of the largest such transactions, the sales of IndyMac Federal Bank, FSB and BankUnited, FSB, the acquiring holding company was a newly formed organization owned almost entirely by a consortium of non-affiliated PE Investors, none of which, alone or in the aggregate, was deemed to control the holding company or the thrift that was organized to acquire the assets and liabilities.<sup>17</sup> However, in its SOP, the FDIC subsequently suggested that it found such ownership structures to present special supervisory issues, and it has imposed special obligations on such acquirers and on any depository institution they may acquire.<sup>18</sup> Many public commenters on the SOP expressed

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and whole bank transactions during the first six months of 2009. “Second Quarter 2009 CFO Report to the Board” at 10, available at [www.fdic.gov/about/strategic/corporate/index.html#2008](http://www.fdic.gov/about/strategic/corporate/index.html#2008).

<sup>12</sup> See, e.g., Purchase and Assumption Agreement, dated Aug. 21, 2009, for the resolution of Guaranty Bank, Austin, Texas, available from the FDIC Failed Bank List.

<sup>13</sup> See, e.g., Purchase and Assumption Agreement, dated Aug. 14, 2009, for the resolution of Colonial Bank, Montgomery, Alabama, available from the FDIC Failed Bank List, and the presentation to investors made by the acquiring institution, BB&T Bank, Winston-Salem, North Carolina, on Aug. 17, 2009, available at [www.bbt.com/bbt/about/investorrelations/recentpresentations.html](http://www.bbt.com/bbt/about/investorrelations/recentpresentations.html).

<sup>14</sup> See, e.g., Purchase and Assumption Agreement for Colonial Bank, *supra*.

<sup>15</sup> *Id.*

<sup>16</sup> Under section 13(c)(4)(A) of the Federal Deposit Insurance Act (FDIA), when the FDIC, in order to facilitate the purchase of any of the assets or assumption of any of the liabilities of one insured depository institution by another insured depository institution, guarantees the acquiring institution against loss by reason of such purchase or assumption, it must determine that such resolution is the least costly alternative to the DIF for meeting the FDIC’s obligations under section 13. 12 U.S.C. § 1823(c)(4)(A).

<sup>17</sup> FDIC Press Release PR-42-2009 (IndyMac Federal Bank, FSB, Pasadena, California) (Mar. 19, 2009); FDIC Press Release PR-72-2009 (BankUnited, FSB, Coral Gables, Florida) (May 21, 2009).

<sup>18</sup> 74 Fed. Reg. at 45446, 45448.

concern that such conditions will discourage PE Investors from bidding for failed institutions or will cause their bids to be non-competitive.<sup>19</sup> Indeed, in the SOP, the FDIC expressly encouraged PE Investors to pursue an alternative acquisition strategy. If a PE Investor invests in, or enters into a joint venture or other arrangement with, a strategic buyer, provided that the strategic buyer has majority control of any depository institution used to assume the deposits of a failed institution, then the PE Investor and the depository institution will not be subject to the SOP.<sup>20</sup>

A joint venture between a PE Investor and a strategic buyer may take several forms. In one model, one or more PE Investors may recapitalize a strategic buyer without acquiring control of the bank or thrift and being themselves required to register as a bank or thrift holding company, yet the strategic buyer may use the capital infusion to acquire a failed institution.<sup>21</sup> However, the amount that a single PE Investor can invest in this manner is limited by the rules of the Federal Reserve Board (FRB) and the Office of Thrift Supervision (OTS) regarding control of banks and thrifts, respectively.<sup>22</sup> Two or more unaffiliated PE Investors can make a larger investment without acquiring control, but such a structure may attract closer scrutiny by the FDIC under the SOP to ensure that such PE Investors are not affiliated and are passive.

Alternatively, one or more PE Investors may co-invest with a strategic buyer in a depository institution organized or acquired to hold the assets and liabilities of a failed institution, provided the strategic buyer is the controlling investor.<sup>23</sup> This arrangement, however, is also subject to limitations on the size of the PE Investors' investment in such a depository institution, on account of the rules of the FRB and the OTS governing control.

One or more PE Investors and a strategic buyer also may agree to a pass-through arrangement in which the strategic buyer acquires the assets and liabilities of a failed institution from the FDIC and sells certain assets to the PE Investors or enters into a structured financial transaction with the PE Investors for the management and liquidation of those assets. A pass-through arrangement is not subject to size constraints based on rules governing control, but it must overcome other significant obstacles. Foremost is that, under a typical loss sharing arrangement, when a loan is transferred to a non-affiliate, it is no longer covered by the loss sharing provision.<sup>24</sup> Therefore, a pass-through arrangement must be negotiated with the FDIC as part of the purchase and assumption of the failed institution. Among other factors, the FDIC must be convinced that the PE Investor has the experience and commitment to administer

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<sup>19</sup> 74 Fed. Reg. at 45443.

<sup>20</sup> 74 Fed. Reg. at 45446, 45448.

<sup>21</sup> While not involving a failed institution, an example of such a transaction was reported in April 2008, regarding a proposal for Kohlberg Kravis Roberts & Co. to make a capital infusion in KeyCorp in order to finance its acquisition of National City Corporation, both of Cleveland, Ohio. Robin Sidel and Valerie Bauerlein, *National City Talks to Key; Credit Crunch Drives Ohio Banks to Consider Idea Dismissed in Past*, WALL ST. J., Apr. 2, 2008, at C1.

<sup>22</sup> For banks and bank holding companies, *see* 12 U.S.C. § 1841(a)(2)(A); *see also* 12 C.F.R. § 225.41(c)(2). For savings associations and savings and loan holding companies, *see* 12 U.S.C. § 1467a(a)(2)(A); 12 C.F.R. § 574.4(b)(1)(i).

<sup>23</sup> 74 Fed. Reg. at 45448.

<sup>24</sup> *See, e.g.*, Sec. 2.7 of the Single Family Shared-Loss Agreement, Ex. 4.15A of the Purchase and Assumption Agreement, dated Sept. 18, 2009, for the resolution of Irwin Union Bank and Trust Company, Columbus, Indiana, available from the FDIC Failed Bank List.

effectively a loan modification or loan refinancing program for the transferred loans, if applicable, without the FDIC or any other federal banking agency having the supervisory authority to hold such PE Investor strictly to account for its actions.<sup>25</sup> In addition, many PE Investors are not authorized to manage and liquidate an asset portfolio, or they are not interested in doing so. Their business model is to provide capital and expertise to operating businesses in order to grow those businesses and increase their value as going concerns before selling them;<sup>26</sup> a pass-through arrangement has no appeal to such PE Investors. Pass-through investors also may have only a limited opportunity to conduct due diligence during the bidding process for an institution about to fail.

While encouraging joint ventures between PE Investors and strategic buyers, the FDIC has not yet approved a joint venture to acquire the assets and liabilities of a failed institution in a loss sharing or other whole bank transaction. It has approved a similar transaction in which a group of investors, none of which were PE Investors, acquired and recapitalized a small strategic buyer in order to engage in a whole bank transaction, but it remains to be seen whether this model can be adapted for PE Investors in a significant number of transactions or for transactions of a significant size.<sup>27</sup>

## Shelf Charters

Shelf charters or inflatable charters have been discussed since late 2008 as a method by which PE Investors and other non-strategic buyers may bid for failed institutions.<sup>28</sup> A shelf charter consists of obtaining preliminary approval from the Office of the Comptroller of the Currency (OCC) to receive a charter and preliminary approval from the FDIC to receive deposit insurance for that charter. On that basis, the investor is eligible to be notified of and to bid on failing institutions as if it owned an operating depository institution.<sup>29</sup> The OTS has a similar, but less formalized, procedure to grant preliminary approval to applicants for a federal thrift charter.<sup>30</sup> However, the preliminary approval process may be arduous. Among other factors, the organizers may have to “lock up” well-qualified senior executive officers far in advance of an acquisition opportunity possibly materializing, and the OCC has imposed stiff enforcement-like operating requirements on such *de novo* organizations.<sup>31</sup>

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<sup>25</sup> The FDIC in this context has expressed the view that banks and thrifts have a special responsibility. *See* 74 Fed. Reg. at 45441 (“The FDIC is particularly concerned that owners of banks and thrifts, whether they are individuals, partnerships, limited liability companies, or corporations, accept the responsibility to serve as responsible custodians of the public interest that is inherent in insured depository institutions. . . .”). The FDIC could seek to have a purchaser under a pass-through arrangement share this responsibility.

<sup>26</sup> *See* Letter from Douglas Lowenstein, President, Private Equity Council, to Robert E. Feldman, Executive Secretary, FDIC, at 2 (Aug. 6, 2009), commenting on the proposed SOP.

<sup>27</sup> FDIC Press Release PR-130-2009 (regarding subsidiaries of Security Bank Corporation, Macon, Georgia) (July 24, 2009).

<sup>28</sup> Office of the Comptroller of the Currency, Press Release NR-2008-137, “OCC Conditionally Approves First National Bank ‘Shelf Charter’ to Expand Pool of Qualified Bidders for Failed Institutions” (Nov. 21, 2008).

<sup>29</sup> FDIC Press Release PR-127-2008, “FDIC Expands Bidder List for Troubled Institutions” (Nov. 26, 2008).

<sup>30</sup> *See* [www.ots.gov/index.cfm?p=PreclearanceProgram](http://www.ots.gov/index.cfm?p=PreclearanceProgram).

<sup>31</sup> *See, e.g.*, Conditional Approval Letter No. 917, to Robert L. Tortoriello, Esq. (July 31, 2009). Before granting final approval, the OCC has required the bank and, in some cases, its investors to enter into an Operating Agreement with the agency. An Operating Agreement may constitute a written agreement and

An inflatable charter is similar to a shelf charter. In that case, a relatively small depository institution is acquired with the expectation that it will be recapitalized when an opportunity arises to acquire a significantly larger open or failed institution.<sup>32</sup>

With either a shelf charter or an inflatable charter, the individual or organization that acquires the institution is deemed to control it. This structure, therefore, is not suitable for a diversified PE Investor that is unable or unwilling to register as a bank or thrift holding company. In addition, the FDIC declared in the SOP that a PE Investor is prohibited from acquiring a depository institution through a “silo” structure, in which one branch of an organization registers as a holding company while the rest of its organization remains unregistered.<sup>33</sup> To date, no bidder has acquired a failed bank or thrift using a shelf charter.

### Split or “Good Bank/Bad Bank” Transactions

Another influence on the development of the FDIC’s efforts to dispose of the assets of failed banks has been the agency’s participation with the Department of the Treasury (Treasury) in the Troubled Asset Relief Program. In March 2009, the Treasury and the FDIC announced the Legacy Loans Program as a partnership intended to help restore liquidity to open banks and thrifts burdened by troubled loans.<sup>34</sup> Under the Legacy Loans Program, the FDIC proposed to acquire loans from participating institutions and place them into several limited liability companies (LLCs) that it would organize. Qualified investors would bid to provide 50% of the equity for those LLCs, and the Treasury would provide the remaining 50%. The FDIC would oversee the selection of loans and other assets to be placed in the LLCs, prescribe how the LLCs would operate and provide a non-recourse guarantee of the obligations issued by the LLCs to pay for the acquired assets.<sup>35</sup> In June 2009, the FDIC announced that a planned pilot sale of loans under the Legacy Loan Program had been postponed.<sup>36</sup> The development of the program was hindered by questions about the role of the government in the management and operation of the LLCs and by an improvement in the financial condition of many of the banks and thrifts that were expected to participate in the program as sellers.<sup>37</sup>

In its June announcement, the FDIC stated that it would continue to develop the funding mechanism of the Legacy Loans Program, drawing in part on the experience of the Resolution

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be subject to the enforcement authority of the OCC under section 8 of the FDIA. 12 U.S.C. § 1818. The bank also must submit a comprehensive business plan that is acceptable to the OCC, and the bank may not significantly deviate from the plan without the prior written consent of the OCC.

<sup>32</sup> See Conditional Approval Letter No. 872, to J. Christopher Flowers (Aug. 27, 2008), not objecting to a notice filed under the Change in Bank Control Act to acquire control of First National Bank of Cainsville, Cainsville, Missouri.

<sup>33</sup> 74 Fed. Reg. at 45447, 45449.

<sup>34</sup> Treasury Press Release tg-65, “Treasury Releases Details on Public Private Partnership Investment Program (Mar. 23, 2009); FDIC Press Release PR-48-2009, “FDIC Seeks Comment on the Recently Announced Legacy Loans Program” (Mar. 26, 2009).

<sup>35</sup> “Public-Private Investment Program,” available at [www.financialstability.gov/roadtostability/publicprivatefund.html](http://www.financialstability.gov/roadtostability/publicprivatefund.html). The non-recourse guarantee would be secured by the loans and other assets acquired by the LLCs.

<sup>36</sup> FDIC Press Release PR-84-2009, “FDIC Statement on the Status of the Legacy Loans Program” (June 3, 2009).

<sup>37</sup> Edmund L. Andrews, *Plan to Help Banks Clear Their Books Is Halted*, N.Y. TIMES, June 4, 2009, at B3.

Trust Corporation (RTC) in the 1990s in financing asset sales through the use of leverage.<sup>38</sup> The FDIC also can draw on its experience in a small number of more recent transactions in which it has sold loan portfolios by accepting a lower purchase price but sharing profits with the purchasers.<sup>39</sup>

In July, the FDIC began to put its new funding mechanism to the test in a series of closed-bid auctions.<sup>40</sup> Using the techniques of the Legacy Loans Program, the FDIC indicated that it would organize a series of LLCs, place whole loans in each LLC, auction off a 50% equity interest in each LLC to a qualified bidder and provide a non-recourse guarantee of the obligations issued by each LLC to pay for the loans. Like the RTC program and the FDIC's profit-sharing arrangements, but unlike the Legacy Loans Program, the FDIC would provide the loans. Borrowing another technique from its profit-sharing arrangements, the FDIC also would accept bids to acquire a smaller equity interest, based on the FDIC entering into a profit-sharing arrangement with the LLC. Distinct from any of the previous programs, the FDIC would provide the matching equity investment in the LLCs in addition to providing the leverage.<sup>41</sup> It also may seek to sell the notes it receives from the LLCs and thereby help to replenish the DIF.

The FDIC reached an agreement for the first such transaction in September 2009 in connection with the sale of \$1.3 billion of residential mortgage loans acquired by the FDIC as receiver in November 2008.<sup>42</sup> Shortly thereafter, in connection with the closing of Corus Bank, N.A., the FDIC conducted a similar bidding process for the sale of substantially all the assets that it acquired as receiver for that institution.<sup>43</sup> The FDIC placed approximately \$4.5 billion of construction loans and foreclosed properties in a LLC and sold a 40% equity interest in the LLC to a single bidder. Significantly, the FDIC was able to schedule the closing to take place within 35 days of the closing of Corus Bank.<sup>44</sup>

This adaptation of the Legacy Loans Program should benefit non-strategic bidders, including PE Investors, by giving them an opportunity to conduct more thorough due diligence regarding the assets of a failed bank or thrift than they could perform on a failing institution in the process of being closed. If the FDIC is able to use this program to sell assets within the timeframe that the FDIC has described for disposing of the assets of Corus Bank, then the FDIC will in effect have established a "good bank/bad bank" model for dealing with failed institutions. In other words, the FDIC will be able to market the "good bank" (consisting of the retail deposit franchise, functional subsidiaries and unimpaired assets) solely to strategic buyers (and avoid

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<sup>38</sup> FDIC Press Release PR-84-2009.

<sup>39</sup> FDIC Press Release PR-26-2009, "FDIC Closes on a \$1.45 Billion Structured Sale of Distressed Loans (Feb. 26, 2009); "Structured Loan Sales" at [www.fdic.gov/buying/historical/structured/](http://www.fdic.gov/buying/historical/structured/).

<sup>40</sup> FDIC Press Release PR-131-2009, "Legacy Loans Program – Test of Funding Mechanism" (July 31, 2009).

<sup>41</sup> FDIC Press Release PR-131-2009.

<sup>42</sup> FDIC Press Release PR-172-2009, "Legacy Loans Program – Winning Bidder Announced in Pilot Sale" (Sept. 16, 2009); FDIC Press Release PR-113-2008 (Franklin Bank, S.S.B., Houston, Texas) (Nov. 7, 2009).

<sup>43</sup> FDIC Press Release PR-168-2009 (Corus Bank, N.A., Chicago, Illinois) (Sept. 11, 2009).

<sup>44</sup> FDIC Press Release PR-183-2009, "Corus Bank Assets – Winning Bidder Announced" (Oct. 6, 2009). The FDIC agreed to finance the transaction by providing a non-recourse loan in the amount of \$1.39 billion (equal to the value of the total equity of the LLC) and a \$1 billion facility to fund the completion of construction. The FDIC also received an "equity kicker" of 10% based on the LLC's performance.

offering it to those strangers to banking whose commitment to retail banking is suspect in the eyes of the FDIC) and simultaneously market the “bad bank” (consisting primarily of impaired assets) to a broader group of qualified investors (which must be able to manage a variety of loan modification or loan refinancing programs applicable to residential loans). Offering the good bank and the bad bank separately should appeal to more bidders and result in a higher total return than if they were sold as a single unit and should cause relatively little increase in the FDIC’s administrative expenses as compared to a loss sharing or other whole bank transaction.

Whether this model will fulfill these expectations may depend on two factors. First, as noted above, many PE Investors may be unable or unwilling to bid for loan portfolios. Prospective investors also must overcome whatever concerns they may have about government restrictions, such as limits on executive compensation, that may be imposed on the LLCs and about the participation of the FDIC in the management of the LLCs, in light of the agency’s large financial stake.<sup>45</sup> Therefore, it remains to be seen how much new capital the FDIC will be able to attract. Second, the obligation of the FDIC to provide 50% of the equity for the LLCs and a non-recourse guarantee for up to approximately 85% of the purchase price of the loans acquired or to provide up to 80% of the equity and loss protection may not achieve the hoped-for savings to the DIF and may not constitute the least-cost resolution of the institutions that fail.

## **Conclusion**

The FDIC has shown significant ingenuity in developing several methods of selling assets and in combining those methods in order to attract new investors. It may have found a way to implement a “good bank/bad bank” resolution model. However, it has also placed a bet that it can convince PE Investors to participate in the resolution process either under an uniquely restrictive set of rules or solely as buyers of assets, rather than as buyers of operating companies. The success of the FDIC’s bet should become apparent in the coming months.

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<sup>45</sup> See note 34, *supra*; TARP Standards for Compensation and Governance, 74 Fed. Reg. 28394 (June 15, 2009) (interim final rule); Robert Reich, *Government in Your Business*, HARV. BUS. REV. (July-August 2009).