

Rules Eased on Bank Buyouts

Hurdles Lowered for Private-Equity Firms in Bid to Drum Up New Rescuers
By Michael R. Crittenden and Peter Lattman

WASHINGTON -- Federal regulators approved watered-down guidelines for private-equity firms seeking to snap up failed U.S. banks, in a bid to tap a new and controversial source of capital for financial institutions.

The new rules still impose significant restrictions on private-equity ownership of banks, but after a ferocious lobbying effort by the buyout industry, the Federal Deposit Insurance Corp. backed away from an initial set of tough proposals that would have imposed heavy capital requirements.

The five-member board of the FDIC voted 4-1 in favor of rules that would require buyout firms to hold on to failed banks they purchase for at least three years. Investors would also be required to maintain larger amounts of high-quality capital at their acquired banks. In both cases, the rules are substantially tougher than those for regular banks competing for the same spoils.

The special standards for private-equity firms highlight a dilemma facing regulators: They need to find buyers for failed banks while ensuring that investors aren't playing the game to turn a quick profit, potentially imperiling again already-weak institutions.

Regulators have shut 81 banks this year, the largest number since the savings-and-loan crisis, and the FDIC's deposit-insurance fund has become strained by expensive and frequent failures. The FDIC's costs are much higher when a bank fails without a ready buyer.



The FDIC's deposit-insurance fund stood at \$13.3 billion as of the end of March, and since then 60 banks have failed at an estimated cost of roughly \$19.3 billion to the federal government. The FDIC has already

provisioned for the current losses, but is considering levying additional fees against the banking industry to help cover the cost of future failures.

Acknowledging that regulators need to find new sources of capital, Comptroller of the Currency John Dugan said investors need to be deemed appropriate.

FDIC Chairman Sheila Bair agreed: "We do want people who are serious running banks."

The lone vote against the deal was from Office of Thrift Supervision's acting director, John Bowman, who said he didn't think regulators should single out private-equity firms for tighter restrictions than other investors or buyers.

For private-equity firms, the vote is a mixed result. The industry lobbied hard against rules proposed by the FDIC in July, flooding the agency with comment letters, and was successful in rolling back some of the more restrictive standards. The changes didn't go far enough for some.

"Requiring us to have effectively twice as much capital as another bidder puts us at a competitive disadvantage," said longtime bank investor Gerald Ford, a general partner at private-equity firm Flexpoint Ford.

Given the opportunities, however, a number of executives at private-equity firms, including Mr. Ford, said they would still seek deals. "We will continue to look," he said.

The proposal approved Wednesday would require private-equity firms to maintain high-quality capital -- known as Tier 1 common equity -- equivalent to 10% of the bank's overall assets. That is lower than the 15% Tier 1 leverage-ratio level proposed in July but higher than the 5% requirement for traditional banks. The FDIC could also impose higher capital requirements in some instances.

The FDIC rules will prevent the private-equity-owned banks from extending credit to private-equity firms' investors and some affiliates, in essence preventing firms from using their acquisitions as a piggy bank.

The agency, however, abandoned language requiring private-equity firms to act as a "source of strength" for purchased institutions.

The FDIC has only twice this year arranged deals with private-equity buyers. In March, a group of investors including J.C. Flowers & Co. acquired IndyMac Federal Bank, which has since been renamed OneWest Banks. And a consortium led by WL Ross & Co. and Blackstone Group LP purchased Florida's BankUnited Financial Corp in May.

Private investors still feel that even with the eased restrictions, the FDIC rules treat them unfairly. They argue the regulations favor existing U.S. and foreign banks over private investors. They also argued that struggling banks are in desperate need of private capital that they, unlike many other financial players, are in a position to offer.

"There is virtually no evidence of regulatory abuse, excessive risk taking, or increased costs for the FDIC due to private-equity control of financial institutions," wrote Guhan Subramanian, a Harvard Business School professor retained by a buyout firm to weigh in on the issue, in a lobbying paper to the FDIC.

The Service Employees International Union, a longtime critic of the buyout industry, pushed for even more-stringent rules. Buyout firms "have leveraged and sometimes drained the value out of their portfolio companies and left them in precarious financial situations," a union official wrote.

Write to Peter Lattman at peter.lattman@wsj.com