

# **FDIC Assisted Transactions – Taking Advantage of Failed Banking Assets**

Presentation to:

**New Jersey Bankers Association and  
Financial Managers Society  
New York/New Jersey Chapter**

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## **Who We Are**

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Luse Gorman Pomerenk & Schick is a Washington, D.C. – based law firm that specializes in mutual-to-stock conversions, mutual holding companies, mergers and acquisitions, executive compensation, regulatory and enforcement matters and general corporate and securities law.

## Introduction

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- Regulatory landscape
  - 122 bank failures so far in 2009
  - Over 400 banks on FDIC's problem bank list
  - FDIC projects at least 800 failures before the crisis passes
- Strategic Planning
  - Opportunities will exist to acquire failed banks – particularly in Southeast and Southwest
  - FDIC assisted transactions offer banks opportunity to grow through acquisitions versus organically

## Getting Started – Who Can Bid?

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- FDIC Supervisory Criteria
  - Total risk-based capital ratio of 10% or higher
  - Tier 1 risk-based capital ratio of 6% or higher
  - Tier 1 leverage capital ratio of 4% or higher
  - CAMELS composite rating of 1 or 2
  - CAMELS Management component rating of 1 or 2
  - Compliance rating of 1 or 2
  - RFI/C rating of 1 or 2 (bank holding companies)
  - Satisfactory or Outstanding CRA rating
  - Satisfactory Anti-Money Laundering Record

## Getting Started – Who Can Bid?

- Total Asset Size and Geographic Criteria
  - Generally, bidder's asset size must be roughly double core deposits of failing bank when bidder is in geographic proximity to failing bank
  - Larger total asset size required when bidder is located in other states
  - Bidders may express preferences for invitation by state

## Getting Started – Who Can Bid?

- Talk to your Primary Federal Regulator before you begin this process. Determine if they have an objection to your bidding.
- Want to receive from your regulator an informal non-objection to participating in the bidding process.
- To bid you must be an existing FDIC-insured financial institution or have a shelf charter approved.

## Getting Started – Who Can Bid?

- Bidding on a failed institution is not an approval of the bid. The winning bidder must obtain final approval from:
  - Primary Federal Regulator
  - FDIC
  - FRB (if holding company involved in acquisition)

## The Bidding Process

- Contact FDIC once your Primary Federal Regulator has expressed no objection to your bidding
- Visit FDIC website to obtain FDIC's standard form Confidentiality Agreement
- Once you execute Confidentiality Agreement, FDIC will give you access to its Intralink which will provide confidential information on banks being marketed for bid by the FDIC

## The Bidding Process

- Due diligence
  - Information downloaded from FDIC's Intralink
  - FDIC will provide limited on-site due diligence
  - Normally a very short process

## Basic Closed Bank Acquisition Structures

All Transactions are Structured as P&As

- P&A Whole Bank – no Loss Share
- P&A Whole Bank – with Loss Share
- P&A Clean (only performing loans and deposits) – No Loss Share
- P&A with Optional Loan Pools – Loss Share typically

## Closed Bank Acquisition

### Assets Typically Excluded from P&A

- Bank Premises (offered under separate 90-day options)
- D&O Liability Claims
- Prepaid Regulatory Assessments
- Tax Receivables
- Loss Reserves (general and specific)
- Private Label Asset-Backed Securities
- Assets that may be involved in fraud
- CDOs

## Closed Bank Acquisition

### Liabilities Typically Excluded from P&A

- Brokered Deposits
- Subordinated Debt

## Specific P&A Provisions

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- Assumption of Liabilities
- Purchased Assets
- Indemnification
- Loss-Share

## Acquiror Issues

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- Closing weekend logistics
- New borrowers
- Accounting treatment

## Closed Bank Acquisitions

### Intangible Considerations

- Communicate with FDIC and Primary Federal Regulator often and regularly
- To date, dealing with FDIC has been a positive experience for most banks
- Be prepared to commit necessary resources

## Principal Terms

- FDIC shares 80% of losses up to the Stated Threshold
  - Stated Threshold = FDIC estimate of projected losses based on third-party valuation
  - 95% thereafter
  - Includes loans, OREO, and some less-than-marketable securities
- Single Family: 10 years
- Commercial: 5 years + 3 years for recoveries
- FDIC Least Cost Objective + Protect Depositors

## The Bank Bid

Bid Components	Definition
1. Deposit Premium	Expressed as a percentage – premium paid on total deposits acquired
2. Net Worth Position	Equity Adjustment (i.e. net assets) is equal to the book value of assets acquired less the book value of liabilities assumed as of bank closing
3. Asset Premium / (Discount) Bid	Represents the future capital and operational gains or losses associated with the acquisition of the bank under the Whole Bank with Loss Share transaction

Bid Amount ( = 1 + 2 + 3 )	If positive, represents the amount of loan losses the buyer will assume before loss share begins. If negative, cash paid to buyer from FDIC
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## The Bank Bid – Example

- FDIC Threshold Amount assumed to be \$150 million (provided by FDIC)
  - FDIC indemnifies 80% of loan losses up to \$150 million
  - FDIC indemnifies 95% of loan losses above \$150 million
- Buyer estimates losses to be \$180 million (per Buyer due diligence)

## Deposit Premium Calculation

- Total deposits assumed (\$000): \$777,480
- Deposit premium: 1.0%
- Total premium component (\$000): \$7,775

↑  
Component 1

## Net Worth Position of Failed Bank

Dollars in thousands

	09/30/09 Balance Sheet	BV of Assets at Bidding
<b>Assets</b>		
Cash	\$ 76,354	\$ 76,354
Securities (No CDOs)	185,941	185,941
CDOs	11,348	-
Fed Funds Sold	29,000	29,000
Loans - "Covered Assets"	608,153	608,153
Reserves	(17,070)	-
FDIC Loss Share Receivable	-	-
Core Deposit Intangible	8	-
Premises & Fixed Assets	26,741	-
OREO	7,975	7,975
Other Assets	34,013	18,137*
	<u>\$ 962,463</u>	<u>\$ 925,560</u>
<b>Liabilities</b>		
		<b>Assumed Liabilities</b>
Non Brokered Deposits	\$ 777,480	\$ 777,480
Brokered	50,963	-
Total Deposits	828,443	777,480
FHLB Borrowings & Repos	99,960	99,960
Subordinated Debt	10,000	-
Other Liabilities	2,618	2,618
	<u>941,021</u>	<u>880,058</u>
	<u>21,442</u>	<u>45,502</u>

\* Excludes BOLI

← Component 2

## Asset Premium / (Discount) Calculation

Asset Adjustments & Transaction Income/Expense Elements	Comments	Adjustment Value (\$000)
Credit - Principal Losses @ 20%	\$150,000 x 20%	\$ (30,000)
Credit - Principal Losses @ 5%	(\$180,000 - \$150,000) x 5%	(1,500)
Credit - Earnings Losses	Estimated lost interest on NPAs	(7,500)
Operating, Reporting and Other Expenses		(15,000)
<b>Total Adjustments - Asset Prem / (Disc) Bid</b>		<b>\$ (54,000)</b>

↑  
Component 3

## Bank Bid Calculation

### Bid Build-Up

Deposit Premium		1.00%	\$ 7,775
Net Worth Position	(1)		45,502
Asset Prem / (Disc) Bid	(2)		(54,000)

**Bid Amount (3) \$ (723)**

- (1) Equity Adjustment (i.e. net assets) is equal to the book value of assets acquired less the book value of liabilities assumed as of bank closing.
- (2) Represents the future capital and operational gains or losses associated with the acquisition of the bank under the Whole Bank with Loss Share transaction.
- (3) A positive number represents the loan losses the buyer will absorb before the FDIC loss sharing begins. Deposit bid plus the transaction bid plus book value of net assets at close.

## Purchase Accounting Marks

<i>Dollars in thousands</i>	Adj. B-Sheet At Transfer from FDIC	FAS 141(R) Accounting Marks	B-Sheet At Closing	
<b>Assets</b>				
Cash	76,354		76,354	(1) Under FAS 141 R, the company will record a purchase accounting mark for the estimate of potential cumulative loss. This will be denoted as "benefits from loss sharing agreement" and together the loans and this receivable will be classified on the balance sheet as "covered assets" - do not carry over the loan loss reserve.
Securities (No CDOs)	185,941		185,941	
CDOs	-		-	
Fed Funds Sold	29,000		29,000	
Loans - "Covered Assets"	608,153	\$ (180,000) <sup>(1)</sup>	428,153	
Reserves	-		-	
FDIC Loss Share Receivable	-	\$ 148,500 <sup>(2)</sup>	148,500	(2) Record the estimated "receivable" from the FDIC pursuant to loss sharing agreement as an asset.
Core Deposit Intangible	-	7,775 <sup>(3)</sup>	7,775	(3) Core deposit intangible created - 1.0% on total deposits.
Premises & Fixed Assets	-		-	
OREO	7,975 <sup>(4)</sup>		7,975	(4) OREO carried at fair market value.
Other Assets	18,137		18,137	(5) Net deferred tax liability created. Equal to the Net Assets Acquired plus core deposit intangible created less the fair market value adjustments (includes FDIC receivable) multiplied by the tax rate (35%).
	<u>\$ 925,560</u>	<u>\$ (23,725)</u>	<u>\$ 901,835</u>	
<b>Liabilities</b>				
Non Brokered Deposits	\$ 777,480		\$ 777,480	
Brokered	-		-	
Total Deposits	<u>777,480</u>		<u>777,480</u>	
FHLB Borrowings & Repos	99,960		99,960	
Subordinated Debt	-		-	
Other Liabilities	2,618	9,051 <sup>(5)</sup>	11,669	
	<u>880,058</u>		<u>889,109</u>	
	<u>45,502</u>	<u>(23,725)</u>	<u>12,726</u>	

Bargain Purchase Option  
(One Time Gain)

## Loss Share Receivable and Buyer Loan Loss Exposure Calculation

	Buyer Loss Exposure	Buyer Estimated Losses (\$180 Million)	Entire Portfolio Loss (\$608 Million)
<b>FDIC Loss Share Receivable</b>			
<i>Dollars in thousands</i>			
Threshold Amount	\$ 150,000	Threshold Amount	\$ 150,000
	x80%		x20%
Loan Loss Indemnification at 80% Level	\$ 120,000	Loan Losses at 20% Level	\$ 30,000
Buyer Estimated Fair Market Value Adjustment	\$180,000	Fair Market Value Adjustment	180,000
Less: Threshold Amount	150,000	Less: Threshold Amount	150,000
	30,000		30,000
	x95%		x5%
Loan Loss Indemnification at 95% Level	\$ 28,500	Loan Losses at 5% Level	\$ 1,500
			\$ 22,908
<b>FDIC Loss Share Receivable</b>	<b>\$ 148,500</b>	<b>Buyer Loss Exposure</b>	<b>\$ 31,500</b>
			<b>\$ 52,908</b>

Buyer Fair Market Value Adjustment: \$180,000

# Capital Impact

## Risk Weighted Assets (RWA) Analysis

	9/30/2009	Risk-Weighted	Weighted Calculation
Risk Weighted Assets			
Cash	\$ 76,354	0%	\$ -
Premises & Fixed Assets	-	0%	-
Loans (nsk assumed by Buyer)	\$ 52,908	100%	\$ 52,908
Loans (nsk assumed by FDIC) <sup>(1)</sup>	555,245	20%	111,049
Securities Available for Sale	185,941	20%	37,188
Fed Funds Sold	29,000	20%	5,800
OREO	7,975	20%	1,595
Other Assets	18,137	100%	18,137
<b>Total Book Value of Assets</b>	<b>\$ 925,560</b>	<b>RWA</b>	<b>\$ 226,677</b>

(1) Per Big Four accounting firm, the basis for the 20% weight is to give effect to the risk that the claims are not 100% collectible from the FDIC

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