



JONES DAY COMMENTARY

PRIVATE EQUITY INVESTMENTS IN BANK HOLDING COMPANIES: THE FED EXPANDS AND CLARIFIES OPPORTUNITIES

On September 22, 2008, the Federal Reserve issued a new policy statement that expands the ability of private equity funds, hedge funds, and other investors to make meaningful investments in bank holding companies and banks without subjecting themselves to regulation under the Bank Holding Company Act of 1956 (the “BHC Act”). The BHC Act imposes significant regulation upon entities that control banks and bank holding companies. In our judgment, this regulatory regime has discouraged private equity investment in banks, but the new policy statement provides enhanced investment opportunities for private equity funds, hedge funds, and other investors in the industry.

The new policy statement provides that the following will not subject private equity or other investors to regulation as bank holding companies under the BHC Act:

- Voting stock ownership is now permitted up to 14.9 percent of the total outstanding voting shares. Previously, this had been limited to 9.9 percent. Properly structured, total equity investments (voting common and preferred stock) may now be up to 33.2 percent, an increase from 24.9 percent, the previous standard.
- Investors may not hold voting common stock resulting from conversion of convertible nonvoting shares, but they may sell such common shares in specified transactions that do not transfer control.
- A private equity investor may be permitted to appoint up to two directors under certain conditions, instead of the one director previously permitted.

- Directors representing minority investors may not serve as chairman of the board of directors or of any committee, and they may not comprise more than 25 percent of any committee or exercise the practical ability unilaterally to make policy or other decisions.
- Investors may communicate with management about the banking organization's policies and operations, including changes in strategic direction or management, *provided* the board, management, and shareholders retain decision-making authority. Investor communications that include threats to divest shares or engage in proxy solicitations are examples of communications that would indicate control.
- Investors with significant business relationships with the bank may be able to exercise a controlling influence. The scope and effects of such relationships will be examined by the Federal Reserve, and arrangements that are non-exclusive, terminable by the bank without penalty, and on market terms will be favored.
- Covenants restricting operations, the selection of management, and strategic matters such as the issuance of capital and mergers are still not permitted, but covenants that restrict the issuance of more senior securities or senior debt and certain other restrictions are permitted in appropriate situations.

The new policy statement provides greater clarity and investment opportunities. Determinations will still be on a case-

by-case basis through direct discussions with the Federal Reserve Board staff. In our experience, many private equity funds and other investors have shied away from investments in this area to avoid regulation under the BHC Act. These investors will find the new policy statement helpful.

LAWYER CONTACTS

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