OCC's Recent 'Shelf' Charter Approval Revives Mechanism for Broader Participation in Failed Bank Auctions

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The Office of the Comptroller of the Currency (OCC) recently approved an organizing group for a "shelf" charter, reviving a mechanism first introduced during the 2008-11 financial crisis to allow for broader participation by private equity and other nonbank investors in the resolution of failed banks.

When a Bank Fails

When a bank fails, its regulators place it in receivership with the Federal Deposit Insurance Corporation (FDIC). The FDIC then controls the bank and is responsible for resolving its failure, including to ensure that depositors at the failed bank are protected up to the legal limit — generally $250,000. The FDIC's most common resolution method has been to select a healthy bank to take over aspects of the failed bank. In the days or weeks preceding the failure, the FDIC confidentially identifies and screens a selection of healthy banks, which are invited to submit bids in a behind-the-scenes auction. In many cases, there is little or no warning prior to a bank's failure and this process must be conducted on a highly expedited timeline. Each participating bank has a limited opportunity to conduct basic diligence and is asked to submit a fairly standardized bid package that sets forth its proposed terms. Proposals typically must indicate whether — and on what terms — the bidding bank will require the FDIC to provide "loss sharing" with respect to the failed bank's assets.

In selecting the winning bidder, the FDIC is required to choose the "least cost resolution" to the Deposit Insurance Fund, which is a fund supported by regular and special assessments paid by banks. Unless circumstances dictate otherwise, bank failures typically occur on Fridays, which allows the FDIC and the winning bidder to close their transaction and make the initial transition over the course of the weekend. In this manner, customers of the failed bank automatically become customers of the healthy bank when regular business resumes on Monday morning.

Nonbank Investors Generally Excluded

Media and other reports often describe these failed bank transactions as if the healthy bank "acquired" the failed bank. However, this shorthand characterization misses an important nuance. In such failed bank transactions, the winning bidder does not acquire the failed bank entity itself (as would generally be the case in an M&A transaction among banks outside of receivership). Rather, the winning bidder acquires from the FDIC only *specified* assets and assumes *specified* liabilities of the failed bank. This purchase and assumption structure allows bidders to leave the other assets and liabilities of the failed bank with the FDIC. For example, bidders often will assume all of the failed bank's deposits but leave behind most of the failed bank's other liabilities (*e.g.*, other borrowings, litigation exposure, various contractual obligations).

This purchase and assumption structure has the practical effect of preventing nonbank investors from participating in these failed bank transactions. From the FDIC's perspective, a key objective is to provide for assumption of the failed bank's deposit liabilities — thereby ensuring that customers do not lose their deposits. But, importantly, the only type of legal entity with the authority to assume deposit liabilities is a bank.[1] Thus, while private equity funds and other nonbank investors can bid on the *assets* of a failed bank, they are

[1] For simplicity, we refer here only to "banks." There are other types of depository institutions (*e.g.*, thrifts, savings banks, industrial loan companies, credit unions) that have authority to assume various types of deposit liabilities.

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not legally able to assume the *deposits* of a failed bank.[2] For this reason, only bidders that have a bank charter are eligible to participate in the FDIC's typical purchase and assumption auction.

'Shelf' Charter as a Mechanism for Broader Participation

On December 21, 2023, the OCC granted preliminary conditional approval for the organization of Porticoes National Bank. In doing so, the OCC has revived a mechanism to allow for broader participation in FDIC failed bank transactions by nonbank investors, including groups backed by private equity and similar investors.

In response to the bank failures that occurred during the financial crisis of 2008-11, U.S. banking regulators adopted processes by which nonbank investors and management teams could seek preliminary clearances — known as a "shelf" charter — to organize a new bank solely for the purpose of participating in FDIC failed bank transactions. A shelf charter is not itself a legal entity, but instead sits on the metaphorical "shelf" and becomes an active bank only if its organizing group wins an FDIC auction and receives final approvals from the appropriate regulators.

Receiving approval for a shelf charter indicates that the OCC has satisfactorily reviewed the qualifications and experience of the proposed key management team members, their high-level business plan and their plan to raise capital. The approval of Porticoes suggests that the OCC is willing to grant shelf charter approvals even if the organizing group remains in the process of identifying investors and raising capital. The OCC stated that Porticoes is "expected to enter into binding commitments with a number of investors." We view this as a more flexible approach on the part of the OCC, which we think could make the shelf charter approach more attractive in practice.

Successful participation by a shelf charter in a failed bank transaction also will require acceptance and approvals from the FDIC and Federal Reserve — both of which will require a fairly comprehensive picture of the group's committed investor base. The FDIC will be particularly focused on ensuring the certainty of funding in the event the shelf charter is selected as the winning bidder. The FDIC also has a 2010 statement of policy on qualifications for failed bank transactions, which was generally aimed at private equity participation in such transactions. The Federal Reserve will review proposals for, among other things, consistency with the Bank Holding Company Act of 1956, which has the practical effect of limiting the ownership level and influence that a single nonbank investor may have over a bank. Thus, receipt of OCC shelf charter approval is just one of the regulatory steps that the organizing group will need to take before being fully qualified to participate in failed bank transactions with the FDIC — but, it is an important step.

Takeaways

The OCC's approval of the Porticoes shelf charter indicates that banking regulators are open to utilizing the tools developed and deployed in response to the 2008-11 financial crisis. Although shelf charters ultimately did not play a major role in the prior crisis, the OCC's recent approval may indicate that, despite potential tailwinds that would come with lower interest rates, regulators still have concerns about possible financial distress in the banking industry. Shelf charters would provide another path for private capital investment. The OCC's approval also may signal that regulators have an increasingly favorable view of the role that private capital and M&A more generally can have in addressing stress in the banking industry.

[2] In cases where the FDIC's initial purchase and assumption transaction with a healthy bank leaves behind select assets with the FDIC, the FDIC will often conduct follow-up asset auctions. Nonbank investors regularly participate in these follow-on asset auctions.

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