OFFICE OF THRIFT SUPERVISION

Approval of Permission to Organize, Holding Company, and Bank Merger Act Applications, and Related Filings, and Acceptance of Control Rebuttals

Order No.: 2010-40
Date: July 9, 2010

Hovde Private Equity Advisors, LLC, Hovde Acquisition I, LLC, Jefferson Bancorp, Inc. (Jefferson), and Financial Services Partners Fund I LLC (Partners Fund), Washington, DC (collectively, Applicants), have applied to the Office of Thrift Supervision (OTS), pursuant to sections 5(e) and 10(e) of the Home Owners’ Loan Act (HOLA), and 12 C.F.R. §§ 552.2-1 and 574.3(a) to organize and acquire Bay Bank, FSB, Lutherville, Maryland (Association). As a result of the transaction, the Association will become a wholly owned, first-tier subsidiary of Jefferson.

In addition, the Applicants have applied to OTS on behalf of the Association: (i) under section 18(c) of the Federal Deposit Insurance Act (the Bank Merger Act), and 12 C.F.R. § 563.22(a), for the Association to acquire deposit liabilities, certain other liabilities, and certain assets, from Bay National Bank, Lutherville, Maryland (National Bank), a national bank for which the Federal Deposit Insurance Corporation (FDIC) will be the receiver at the time of the transaction; and (ii) for a limited waiver of the Qualified Thrift Lender (QTL) requirement.

Also, EREF-MP Alpha LLC and Related Entities (EREF Group), and Freestone Advantage Partners LP and Related Entities (Freestone Group) have filed rebuttals of control pursuant to 12 C.F.R. § 574.4(e) with respect to their proposed acquisition of between 10.00 and 24.99 percent of the membership interests of Partners Fund.

Background

Jefferson, a corporation formed under Delaware law, is a wholly owned subsidiary of Partners Fund, which is a limited liability company formed under Delaware law. Partners Fund will be capitalized by several parties, including, among others, the EREF Group and the Freestone Group.
The Proposed Transaction

The Applicants propose to form the Association as a federally chartered savings association. The Association will be a wholly owned, direct subsidiary of Jefferson. After completion of its organization, the Association will acquire the deposit liabilities, certain other liabilities, and certain assets, of the National Bank. Upon consummation of the proposed transactions, the Association will be well capitalized.

Permission to Organize Application

OTS may grant a federal savings association charter only: (1) to persons of good character and responsibility; (2) if, in OTS’s judgment, a necessity exists for such association in the community to be served; (3) if there is a reasonable probability for the association’s usefulness and success; and (4) if the association can be established without undue injury to properly conducted existing local thrift and home financing institutions. In addition, OTS must consider whether the association will promote credit for housing consistent with the safe and sound operation of a federal savings association.

Also, 12 C.F.R. § 563e.29(b) provides that an applicant for a federal savings association charter must submit with its application a description of how it will meet its Community Reinvestment Act (CRA) objectives. OTS is required to take this description into account when considering the application and may deny or condition approval on CRA grounds.

With respect to character and responsibility, the application and OTS’s background checks have not disclosed any information regarding the management officials or controlling persons of the Applicants and the Association, that would be inconsistent with approval, and indicate that the Association’s proposed directors, officers and controlling persons possess sufficient experience in the operations of financial institutions and other business endeavors. However, OTS’s background checks of certain individuals have not been completed. OTS is imposing condition ten to help ensure that the character and responsibility of the relevant individuals are consistent with approval.

With respect to the necessity for the Association, and undue injury to local thrift and home financing institutions, the Association is being formed in order to succeed to the business operations of the National Bank, which already engages in deposit and lending activities through three offices. The fact that the activities in question are already being conducted in the community supports the conclusion that there is a necessity for such services. Also, other thrift and home financing institutions already compete with the National Bank, which engages in mortgage lending. Accordingly, OTS concludes that there is a necessity in the community for the Association and that the formation of the Association will not cause undue injury to existing local thrift and home financing institutions.
With respect to the probability of the Association’s usefulness and success, the Association will be well capitalized. OTS has reviewed the Association’s draft business plan and has concluded that it is acceptable. The Association’s directors and management are experienced in the areas of the Association’s proposed operations. OTS is imposing condition four in order to ensure that the Association operates pursuant to an acceptable final business plan. OTS is imposing conditions five and six to help ensure that operations will comply with the business plan. OTS is imposing condition seven to help ensure that the Association is operated properly. OTS is imposing conditions eight through thirteen to help ensure the safe and sound operations of the Association by requiring OTS review and non-objection for certain contracts or agreements and new officers or directors, and ensuring that there is at least one entirely independent member of the Association’s board. OTS concludes that the probability of the Association’s usefulness and success standard is met, provided that the Association complies with the imposed conditions.

With respect to promotion of credit for housing consistent with the safe and sound operation of a federal savings association, the Association will extend credit for housing within its market area. As discussed above, the Association’s management is competent and should be able to conduct lending appropriately. Accordingly, OTS concludes that this approval criterion has been satisfied.

With respect to the CRA and OTS’s CRA regulations, the Association will continue most of the business operations of the National Bank, which had previously received a CRA rating of “Satisfactory.” The Association’s proposed CRA assessment area is consistent with OTS’s CRA regulations. OTS concludes that the Association has satisfactorily demonstrated how it will meet its CRA objectives.

The Association intends to adopt a charter and bylaws that substantially conform to the model charter and bylaws for a federal stock institution.

Because the Association is being formed to acquire the operations of a national bank that is in default, pursuant to 12 C.F.R. § 552.2-3, OTS concludes that the public notice and comment procedures referenced in 12 C.F.R. § 552.2-1 are not applicable to the proposed transaction.

**Holding Company Application**

Section 10(e)(1)(B) of the HOLA and the Control Regulations\(^1\) provide that OTS must approve a holding company application seeking permission to acquire one savings association by a company other than a savings and loan holding company unless OTS finds the financial and managerial resources and future prospects of the company and association involved to be such that the acquisition would be detrimental to the savings association or to the insurance risk of the Deposit Insurance Fund (DIF). Also, OTS must

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\(^1\) 12 C.F.R. Part 574 (2009).
consider the impact of any acquisition on competition. In addition, 12 C.F.R. § 563e.29 requires that OTS take into account assessments under the CRA when considering holding company acquisitions.

OTS has reviewed the information submitted by the Applicants with respect to the Applicants’ management and controlling persons and the proposed management of the Association, and has concluded that the existing and proposed management and controlling persons possess the requisite experience and integrity. OTS is imposing condition eleven in order to ensure that the Applicants’ managerial resources are consistent with approval. OTS concludes that the managerial resources of the Applicants and the Association are consistent with approval, provided the Applicants comply with the condition.

With respect to financial resources, OTS concludes that each of the Applicants has adequate capital. The Applicants will infuse capital into the Association in order to cause the Association to be well capitalized upon consummation of the proposed transaction. Accordingly, OTS concludes that the financial resources of the Applicants and the Association are consistent with approval.

With respect to future prospects and the risk to the DIF, the managerial and financial resources of the Applicants and the Association are consistent with approval, and OTS has considered the Association’s business plan. OTS is conditioning approval of the holding company application upon conditions four through nine and eleven through thirteen for the reasons discussed above. The conditions are intended to ensure that the future prospects of the Association are consistent with approval.

With respect to competitive considerations, the proposed transaction will not cause any existing depository institutions to become affiliated. Accordingly, in our opinion, the proposed acquisition will have no significant effect on competition, and there is an adequate legal basis to conclude that this approval criterion has been satisfied.

With respect to the CRA, the Applicants have not been subject to the CRA. The National Bank, which previously conducted the operations being transferred to the Association, received a “Satisfactory” CRA rating in its most recent examination, dated October 6, 2008. Accordingly, OTS concludes that this approval criterion has been satisfied.

Because the proposed transaction is being undertaken and approved for supervisory reasons, pursuant to 12 C.F.R. § 574.6(g), OTS hereby waives the applicability of the public notice and comment procedures of 12 C.F.R. §§ 574.6(d) and 574.6(e).

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2 12 U.S.C. § 1467a(e)(2) and 12 C.F.R. § 574.7(c)(2) (2009).
Bank Merger Act (BMA) Application

The Applicants seek OTS approval for the Association’s acquisition of the deposit liabilities, certain other liabilities, and certain assets of the National Bank, pursuant to the BMA and 12 C.F.R. § 563.22(a). Because the National Bank will be in receivership at the time of the proposed transaction, there are sufficient grounds for OTS to waive the publication requirement set forth in the BMA and 12 C.F.R. § 563.22(e), and any waiting period for consummation of the transaction, and OTS hereby waives these requirements.

In evaluating a BMA application, OTS considers the effect on the capital of the resulting association; the financial and managerial resources of the constituent institutions; the future prospects of the constituent institutions; the convenience and needs of the community; conformance of the transaction to applicable law, regulation, and supervisory policy; and factors relating to the fairness of and disclosure concerning the transaction. In addition, in evaluating a BMA application, OTS considers the effect of the proposed transaction on competition, and the effectiveness of the depository institutions in combating money-laundering activities. OTS also considers the constituent savings associations’ record of performance under the CRA.

As for capital, the Association will be well capitalized after the transaction. Accordingly, OTS concludes that this approval criterion has been satisfied.

As for managerial resources, for the reasons discussed above, OTS concludes that the managerial resources of the resulting savings association, the Association, are consistent with approval.

As for financial resources, OTS has concluded that the Applicants have adequate capital. The Applicants will infuse capital into the Association in order to cause the Association to be well capitalized upon consummation of the proposed transaction. The Association is projected to be well capitalized for the term of its business plan. Accordingly, OTS concludes that the financial resources of the Applicants and the Association are consistent with approval.

As for future prospects, OTS has considered the managerial and financial resources of the Association, as well as its business plan, and has concluded that future prospects considerations are consistent with approval, subject to imposition of the conditions discussed above.

As for convenience and needs of the community, the proposed transaction will help ensure that the customers of the National Bank continue to receive the services that the National Bank has provided. Accordingly, OTS concludes that convenience and needs considerations are consistent with approval of the proposed transaction.

As for the CRA, the National Bank had received a “Satisfactory” CRA rating. The Association, at the time of the transaction, will be newly organized and have no CRA
history. Based on the foregoing, OTS concludes that approval of the proposed transaction is consistent with the CRA.

As for conformance to law, regulation and supervisory policy, OTS’s review of the Applications has not indicated any violation of law or regulations, or non-compliance with supervisory policies, in connection with the proposed transaction. Based on the foregoing, in our opinion, OTS concludes that approval of the proposed transaction is not objectionable based on conformity of the proposed transaction to applicable law, regulations, and supervisory policies.

As for compliance with anti-money laundering statutes and regulations, in January 2008, OTS conducted an examination of the National Bank, and found its effectiveness in combating money laundering to be satisfactory. It is our understanding that the Association will continue to follow the same policies and procedures for combating money laundering as had the National Bank. Moreover, nothing has come to our attention that indicates that the National Bank’s effectiveness in combating money laundering is less than satisfactory.

As for factors regarding equitable treatment and disclosure, employment contracts, and advisory boards, OTS’s review of the applications provided no evidence that the proposed transaction would not be equitable to all concerned. On the basis of the foregoing, OTS concludes that approval of the proposed transaction is not objectionable based on equitable treatment, disclosure, or compensation issues.

As for the competitive effects of the proposed transaction, the proposed transaction will not result in the affiliation of two operating depository institution. To the extent that the proposed transaction results in a more effective competitor in the market, the transaction will have the effect of promoting competition. Based on the foregoing, OTS concludes that the competitive considerations are consistent with approval.

Rebuttals of Control

The Control Regulations state that an acquiror is deemed, subject to rebuttal, to have acquired control of a savings association if the acquiror, directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies, acquires more than 10 percent of any class of voting stock of a savings association and is subject to any control factor, as described in 12 C.F.R. § 574.4(c). The EREF Group and Freestone Group each will hold less than 25 percent of Partners Fund’s membership interests, and each is subject to a control factor. See 12 C.F.R. § 574.4(c)(1) (2009).

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3 The definition of "savings association" includes savings and loan holding companies. See 12 C.F.R. § 574.2(p) (2009).
4 12 C.F.R. § 574.4(b)(1)(i) and 574.4(c) (2009)
Parties attempting to rebut control are required to file a submission setting forth facts and circumstances supporting their contention that no control relationship would exist after the proposed acquisition. In addition, such parties must file a rebuttal of control agreement.

OTS may reject any control rebuttal that is inconsistent with the facts and circumstances known to it, or which does not clearly and convincingly rebut the presumption of control. If OTS concludes that it would be injudicious to rely on an acquiror’s representations, based on past activities of the acquiror, or other concerns, OTS may conclude that the acquiror has not clearly and convincingly rebutted a determination of control. In addition, an acquiror that is in conclusive control of a savings association may not rebut control.

An acquiror is in conclusive control of a savings association if, among other things, it has more than 25 percent of any class of the entity’s voting stock, or it has contributed more than 25 percent of a holding company’s capital. The rebuttal filings demonstrate that neither of the EREF Group, nor Freestone Group will acquire more than 25 percent of a class of Partners Fund’s voting stock, and neither group will have contributed more than 25 percent of Partners Fund’s capital in connection with the proposed transaction.

The EREF Group and the Freestone Group have filed written submissions setting forth facts and circumstances in support of their contention that no control relationship will exist between either of the groups and the Applicants, or the Association. The EREF Group and the Freestone Group each represent that they will acquire Partners Fund securities for investment purposes only, and not for the purpose, or with the effect, of controlling, directly or indirectly, the management, policies, or business operations of the Applicants, or the Association.

The EREF Group and the Freestone Group have submitted rebuttal of control agreements that conform to the standard rebuttal agreement, set forth at 12 C.F.R. § 574.100.

**QTL Waiver**

Section 552.13(c)(3) provides that OTS may grant a QTL exemption in the context of a combination involving a federal savings association.

In this case, the Association, in a supervisory transaction, will acquire a significant amount of non-QTL-qualifying-assets at a time when the mortgage and real estate markets are experiencing a high degree of stress and uncertainty. Accordingly, the Association has requested that the waiver extend through September 30, 2011.

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5. See 12 C.F.R. § 574.4(a) (2009). The section lists additional conclusive control criteria, but it is clear that none of those criteria is applicable in this case.
In order to achieve and maintain a QTL ratio in excess of 65 percent, the Association will sell current investments or redirect current liquidity to granting mortgage loans and acquiring other qualifying assets. Given the need to execute a gradual increase in qualified investments prudently so as not to raise supervisory concerns and the uncertainties of the current economic environment, OTS has determined that granting the temporary exemption from the QTL requirements through September 30, 2011, will ensure that the Association has adequate time to invest in QTL-qualified assets in a safe and sound manner. Accordingly, the Association’s request for a temporary exemption from the QTL requirements through September 30, 2011, is hereby granted.

Conclusion

Based on the foregoing analysis, OTS concludes that the permission to organize application, holding company application, BMA application and QTL waiver request meet the applicable approval criteria. Accordingly, the applications are hereby approved, subject to the following conditions:

1. The proposed transaction must be consummated within 30 calendar days from the date of this Order, and the Applicants must obtain all required regulatory approvals prior to consummation;

2. Prior to the consummation of the proposed transaction, the chief financial officers of the Applicants must certify in writing to the Southeast Regional Director or his designee (Regional Director) that no material adverse changes have occurred with respect to the financial condition or operation of the Applicants, respectively, as disclosed in the applications. If additional information having a material adverse bearing on any feature of the applications is brought to the attention of Applicants, or OTS since the date of the financial statements submitted with the applications, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to consummation of the transaction;

3. The Applicants must, within 5 calendar days after the effective date of the proposed transaction: (a) advise the Regional Director in writing that the transaction was consummated in accordance with all applicable laws and regulations, the applications, and this Order; and (b) provide a reconciliation of the Association’s capital to the Regional Director;

4. The Association must file with the Regional Director, with a copy sent to the FDIC Regional Office, a comprehensive three-year business plan, including a CRA plan, that supports the most recent pro forma financial data submitted with the applications within 60 calendar days after the
consummation of the proposed transaction, and obtain the prior written non-objection of the Regional Director for that plan prior to its implementation;

5. The Association must operate within the parameters of the comprehensive three-year business plan. The Association must submit any proposed major deviations or material changes from the plan (including those initiated by the Applicants) for the prior, written non-objection of the Regional Director. The request for change must be submitted no later than 60 calendar days prior to the desired implementation date with a copy sent to the FDIC Regional Office;

6. For three years following consummation of the transaction, the Association must submit to the Regional Director within 45 calendar days after the end of each calendar quarter, a business plan variance report detailing the Association’s compliance with the business plan and an explanation of any material deviations;

7. The Association must submit independent audit reports to the Regional Director for three years after the date of consummation of the transaction. These reports must be in compliance with the audit rules set forth at 12 C.F.R. § 562.4;

8. For eighteen months following consummation of the transaction, any contracts or agreements pertaining to transactions with affiliates, affiliated persons or related interests not yet submitted to OTS for review, or any material changes to previously submitted contracts or agreements, must be provided to the Regional Director, and obtain his written non-objection;

9. At least 40 percent of the Association's board of directors must be individuals who are not officers or employees of the Association, the Applicants or affiliates thereof, and who have not otherwise been determined by the Regional Director to lack sufficient independence; at least one member of the Association's board of directors must be an individual who is not an officer, director or employee of the Association, the Applicants or affiliates thereof and who has not otherwise been determined by the Regional Director to lack sufficient independence; and at least 50 percent of any audit committee established by the Association must be directors who are not officers or employees of the Association, the Applicants or affiliates thereof and who have not otherwise been determined by the Regional Director to lack sufficient independence. Within 60 calendar days of the consummation of the transaction, the Association must appoint the independent director, subject to the review and written non-objection of the Regional Director;
10. With respect to any proposed director and senior executive officer for whom background checks have not been completed, the Applicants and the Association must take such action as required by the Regional Director, if the Regional Director objects to any such person based on information obtained during the background check;

11. Within 60 calendar days following consummation of the transaction, all directors and senior executive officers of the Applicants and the Association must be identified and their service subject to the review and written non-objection of the Regional Director;

12. For two years following consummation of the transaction, the Association must receive the prior written non-objection of the Regional Director for any proposed new directors or new senior executive officers, or for any significant change in responsibilities of any senior executive officer; and

13. For two years following consummation of the transaction, the Association must receive the prior written non-objection of the Regional Director for the terms of compensation or employment for any proposed new directors or new senior executive officers.

In addition, based on the foregoing analysis, OTS concludes that the rebuttals of control by the EREF Group and Freestone Group meet the applicable criteria. Accordingly, the rebuttals of control are hereby accepted.

By order of the Acting Director of the Office of Thrift Supervision, or his designee, effective July 9, 2010.

[Signature]

Grovetta N. Gardineer
Managing Director
Corporate & International Activities