

OFFICE OF THRIFT SUPERVISION

Approval of Holding Company and Related Applications

Order No.: 2003-24

Date: June 24, 2003

Docket Nos.: H-3715, H-3356, 02319,
H-3152, H-3153, 04684

Kearny MHC, Kearny, New Jersey (MHC-1) and Kearny Financial Corp., Kearny, New Jersey (Holding Company) (collectively, Applicants) have applied pursuant to 12 U.S.C. § 1467a(e) and 12 C.F.R. § 574.3, for approval of the Office of Thrift Supervision (OTS) to acquire West Essex Bank, Caldwell, New Jersey (Association). In addition, Kearny Federal Savings Bank, Kearny, New Jersey (Savings Bank) and the Association have applied to OTS to make capital distributions under the OTS Capital Distribution Regulations.

On June 13, 2003, pursuant to Order No. 2003-22, OTS approved a related application under 12 U.S.C. § 1828(c) and 12 C.F.R. §§ 552.13 and 563.22(a), for the merger of the Association into the Savings Bank. This Order addresses the remaining applications pertaining to MHC-1's acquisition of the Association, and sets forth OTS's policy respecting how it expects to review applications proposing similar transactions in the future.

The Applications

MHC-1, the top tier holding company in a federally chartered mutual holding company structure, wholly owns the Holding Company, a federally chartered subsidiary mutual holding company, which owns all of the common stock of the Savings Bank. The Applicants propose to purchase the outstanding shares of West Essex Bancorp, Inc., Caldwell, New Jersey (Mid-Tier), a federally chartered, subsidiary mutual holding company, held by shareholders (Minority Shareholders) other than the Mid-Tier's controlling mutual holding company, West Essex Bancorp, M.H.C., Caldwell, New Jersey (MHC-2). In order to consummate the acquisition, the Holding Company will organize Kearny Financial Merger Sub, Inc., as a wholly owned subsidiary, to merge with and into Mid-Tier, with Mid-Tier being the resulting entity; MHC-2 will merge with and into MHC-1, with MHC-1 being the resulting entity (MHC Merger); Mid-Tier will merge with and into the Holding Company, with the Holding Company being the resulting entity; and the Association will merge with and into the Savings Bank, with the Savings Bank being the resulting institution. Pursuant to the Merger Agreement, each share of Mid-Tier common stock held by Minority Shareholders will be converted into the right to receive \$35.10 in cash. The outstanding shares of Mid-Tier held by MHC-2 will be canceled upon or immediately after the MHC merger. As a result of the mergers,

the interests of the Association's depositors as members of MHC-2 will cease to exist and will be converted into interests of the same nature in MHC-1.¹

Concerns With "Remutualization" Transactions

OTS first raised concerns about remutualization transactions in April 2002.² At that time OTS focused on the pressure minority stockholders might bring on newly organized mutual holding companies to sell themselves to other entities. Subsequently, a number of transactions have occurred that have brought additional issues to OTS's attention.

Mutual holding companies are required to own more than 50 percent of the stock of (a) a subsidiary savings association that was formerly a mutual savings association or (b) a subsidiary mutual holding company.³ Because up to 50 percent of the subsidiary's stock can be held by investors it is possible for another mutual savings association or mutual holding company to acquire such a company with a cash outlay that is less than it would have to make to acquire a comparable all stock company. On the other hand, the minority investors in such a situation may receive cash far in excess of the proportional value of their interest in the company being sold. The ability to acquire a company for a lower cash pay out combined with the ability of the minority stockholders to obtain more than their proportional interest creates powerful incentives to undertake such transactions. Finally, because the account holders in the acquired institution become members of the acquiring savings association or mutual holding company they dilute the inchoate interest of the other mutual members to the extent that the stockholders are paid a disproportionate sum for their interest in the acquired institution.

Policy Statement

A. Standard of review

When OTS reviews applications to approve remutualization transactions it must consider the convenience and needs of the community to be served.⁴ The convenience and needs of the community includes the transaction's impact on the mutual members of the respective entities involved in it. Also, when a transaction involves combining savings associations, OTS reviews whether the transaction is fair and equitable to all concerned.⁵

¹ This kind of transaction, in which the minority stockholders of a mid-tier mutual holding company (or a savings association subsidiary of a mutual holding company from which the mutual holding company draws its members) are bought out in conjunction with an acquisition by another mutual holding company or a mutual savings association, is referred to herein as a "remutualization" transaction.

² See, 67 Fed. Reg. 17228, 17233 (April 9, 2002).

³ See, 12 C.F.R. 575.7(a)(5), 575.14(b) (2003).

⁴ See, 12 1467a(e), 1828(c)(5).

⁵ See, 12 C.F.R. 563.22(d)(1)(vi) (2003).

For the reasons discussed above, remutualization transactions raise significant issues concerning disparate treatment of minority stockholders and mutual members of the target entity and also raise issues concerning the effect on the mutual members of the acquiring entity. These issues impact OTS's consideration of the convenience and needs of the community and the fairness of the transaction. Particularly where such transactions exceed any of the following parameters, OTS intends to give these concerns special scrutiny and reject such applications unless the applicants can clearly demonstrate to OTS that such concerns are not warranted in the particular case. Moreover, simply providing fairness opinions asserting that the transaction is fair will not suffice. Rather, empirical data that demonstrates that the minority stockholders are receiving a reasonable value in proportion to their interest in the company should be provided. Furthermore, if a proposed transaction exceeds any of the following parameters, OTS will consider imposing a condition requiring approval of the transaction by affirmative votes of the majority of the votes eligible to be cast by their respective members without the use of running proxies.

B. Parameters for triggering special scrutiny

1. Members of acquired entity

OTS will closely scrutinize remutualization transactions in which the members of the acquired entity:

- a. Obtain a right to a distribution in liquidation that is less in value than the corresponding right that they had in the acquired entity; or
- b. Receive subscription rights less than those they had in the acquired entity.

2. Minority stockholders of acquired entity

OTS will closely scrutinize remutualization transactions in which any of the following conditions exist:

- a. The minority stockholders own, in the aggregate, less than 40 percent of all the issued and outstanding stock in the acquired entity.
- b. The ratio of the aggregate purchase price to the book value of the minority interest exceeds the ratio of the purchase price to book value of the highest priced transaction in the third quartile⁶ of all acquisitions of all stock institutions⁷ announced during the preceding four quarters.

⁶ The quartiles will be determined separately for each category, e.g., price to book, and computed by taking the number of all relevant transactions and dividing them into four equal quartiles.

⁷ Entities with a mutual ownership interest such as mutual holding companies with minority stock issuances will be excluded from the calculation of the quartiles.

c. The ratio of the aggregate purchase price to the tangible book value of the minority interest exceeds the ratio of the purchase price to tangible book value of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

d. The price to return on average assets exceeds the corresponding ratio of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

e. The price to earnings per share exceeds the corresponding ratio of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

3. Members in acquiring entity

OTS will closely scrutinize remutualization transactions in which the interests of members in the acquiring entity are diluted by more than they would be under any of the following conditions:

a. The ratio of the aggregate purchase price to the book value of the minority interest did not exceed the ratio of the purchase price to book value of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

b. The ratio of the aggregate purchase price to the tangible book value of the minority interest did not exceed the ratio of the purchase price to tangible book value of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

c. The price to return on average assets did not exceed the corresponding ratio of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

d. The price to earnings per share did not exceed the corresponding ratio of the highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters.

The Pending Applications

The Applicants' acquisition of the Association requires OTS approval under section 10(e) of the Home Owners' Loan Act (HOLA), and OTS's regulations thereunder (Control Regulations). Section 10(e) of the HOLA and the Control Regulations require that OTS consider, with respect to the proposed transactions, the financial and managerial resources and future prospects of the Applicants, the Savings Bank and the Association, the effect of the acquisition on the savings associations, the insurance risk to the Savings

Association Insurance Fund (SAIF), and the convenience and needs of the community to be served. OTS also must consider the impact of the acquisition on competition. Further, 12 C.F.R. § 563e.29(a) requires that OTS take into account assessments under the Community Reinvestment Act (CRA) when approving holding company acquisitions.

OTS did not announce the criteria enunciated in the policy statement set forth above in time to give the Applicants a reasonable opportunity to attempt to provide the necessary empirical data to demonstrate that the transaction meets the convenience and needs of the community and is fair and equitable to all concerned. Accordingly, OTS is reviewing the holding company application here on the basis of the record already before the agency, and the relevant statutory and regulatory approval standards, without applying the policy announced above to its review of the subject applications.

As for managerial resources, OTS, in its role as the regulator of the Applicants, the Savings Bank and the Association, is familiar with their managerial resources. Upon consummation of the acquisition of the Association, the board of directors and the executive officers of the Applicants and the Savings Bank will consist of the present directors and executive officers of the Applicants and the Savings Bank with the addition of one director who is now a director, the President and Chief Executive Officer of Association. The remaining members of the Association's current board of directors will serve as advisory directors of the Savings Bank for one year, renewable annually for two more years. Based on its experience with the managerial resources of the Applicants and the Association, OTS concludes that the Applicants' and the Association's managerial resources are consistent with approval.

As for financial resources, OTS is familiar with the financial resources of the Applicants, the Savings Bank and the Association. As of December 31, 2002, the Savings Bank's Tier 1, Tier 1 Risk-Based and Total Risk-Based capital ratios were 13.26%, 41.27%, and 43.32%, respectively. Upon consummation of the transaction, the Savings Bank will remain "well capitalized" pursuant to the OTS Prompt Corrective Action (PCA) regulation. OTS also has considered the financial resources of MHC-1 and Holding Company. Based on the foregoing, OTS concludes that the financial resources of the Applicants and the resulting institution are consistent with approval.

Based on its consideration of the managerial and financial resources of the Applicants, the Savings Bank, and the Association, OTS concludes that the future prospects of the Applicants, the Savings Bank, and the Association, and the effect of the transaction on the SAIF are consistent with approval, provided that OTS imposes the conditions set forth below.

As for the competitive impact of the transaction, OTS concludes that there is no material effect on competition in the three New Jersey counties where the Savings Bank and the Association both have branches. The application indicates that in Bergen County, New Jersey, there will be a one-point increase in the Herfindahl-Hirschman index (HHI) from 1,283.2 to 1,284.2 upon consummation of the transaction. Moreover,

the Savings Bank will be only the thirteenth largest of 47 depository institutions in that market. Similarly, in Essex County, New Jersey, the HHI will increase less than one point from 784.5 to 784.9 and the Savings Bank will be the twentieth largest of 34 institutions in that market. In Morris County, New Jersey, the effect on competition is also negligible, with the HHI increasing less than one point from 1016.9 to 1,017.2 and the Savings Bank being the nineteenth largest of 33 institutions. The Department of Justice's competitive factors report has not objected to the transaction.

As for CRA, the Savings Bank's and the Association's most recent CRA ratings are "Satisfactory." No comments objecting to the Applications have been filed. Accordingly, OTS concludes that approval of the transaction is consistent with the CRA.

As for convenience and needs, the Savings Bank will be assuming the operations of the Association's existing offices and providing continuing services to the offices' customers and communities. Moreover, the Applications indicate that the transaction was negotiated at arms'-length, both the Association and the Savings Bank obtained fairness opinions reflecting that the transactions are fair to Minority Shareholders and MHC-2's members, and MHC-1's members, respectively. Accordingly, OTS concludes that approval of the transaction is not objectionable based on convenience and needs.

Capital Distribution Notice

Both the Savings Bank and the Association seek OTS approval to make capital distributions to Holding Company and Mid-Tier, respectively. OTS's Capital Distribution Regulations require OTS to consider a savings association's capital position upon completion of the capital distribution, the effects of the capital distribution on the safety and soundness of the savings association, and the conformity of the capital distribution with applicable statutes, regulations, and other limitations. Based on the Savings Bank's and the Association's capital position after the transaction, relevant safety and soundness considerations, and the fact that the distribution does not violate any relevant statute, regulations, or other provision, OTS concludes that the Savings Bank's and the Association's proposed capital distributions in connection with the proposed transaction are consistent with approval.

Mutual Holding Company Considerations

Section 575.10 of OTS's regulations provides authority for the transaction.⁸ The regulation explicitly authorizes MHC-1 to acquire MHC-2. In substance, MHC-1 is acquiring both of the Association's holding companies. While, in form, MHC-1 is not directly acquiring the Association's mid-tier holding company, OTS attempts to avoid elevating form over substance. Moreover, the regulation was intended to prevent a diminution of the interests of the depositor members of a top-tier mutual holding company by preventing such a company from being acquired by a mid-tier holding

⁸ 12 C.F.R. § 575.10(a)(3) (2003).

company owned by stockholders. In this case, no top-tier mutual holding company is being acquired by a subsidiary holding company. Therefore, the intent of the regulation is achieved here.

In addition, 12 C.F.R. § 575.5(a)(2) and (4) require, under these circumstances, that depositors of the Association, who currently have membership rights in MHC-2, receive, after the transaction, the same rights in MHC-1 as depositors of the Savings Bank, and borrower members be granted the same rights as borrower members of MHC-1. OTS has reviewed the proposed charter for MHC-1 and the representations made in the Applications, and concludes that these regulatory requirements have been satisfied.

Conclusions

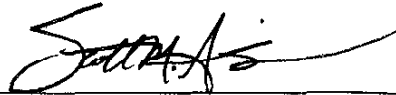
Based on the foregoing analysis, OTS concludes that each of the foregoing Applications meet the applicable approval criteria. Accordingly, the foregoing Applications are hereby approved, provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director, or his designee (Regional Director):

1. The Applicants, the Savings Bank, MHC-2, Mid-Tier and the Association must receive all required regulatory and shareholder approvals for the proposed transaction and submit copies of such approvals to the Regional Director prior to the consummation of the proposed transaction;
2. The proposed transaction must be consummated no later than 120 days from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transactions, the chief financial officers of the Applicants, the Savings Bank, MHC-2, Mid-Tier and the Association must certify in writing to the Regional Director that no material adverse events or material adverse changes have occurred with respect to the financial condition or operations of their respective entities, since the date of the financial statements submitted with the applications. If additional information having a material adverse bearing on any feature of the applications is brought to the attention of the Applicants, the Savings Bank, MHC-2, Mid-Tier, the Association 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; and
4. The Applicants and the Savings Bank must advise the Regional Director in writing within five calendar days after the effective date of the proposed transaction (a) of the effective date of the transaction, (b) that the

transaction was consummated in accordance with all applicable laws, regulations, the Applications and this Order, and (c) must provide a reconciliation of the Savings Bank's capital.

Any time period set forth herein may be extended for up to 120 calendar days, for good cause, by the Regional Director.

By order of the Director of the Office of Thrift Supervision, or his designee, effective June 24, 2003.



Scott M. Albinson
Managing Director
Office of Supervision