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November 9, 2000

Manager
Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Attention: Docket No. 2000-57

Re: Proposed Amendment to Conversion Regulations

Ladies and Gentlemen:

On July 12, 2000 the Office of Thrift Supervision ("OTS") published a notice of proposed rulemaking governing mutual savings associations, mutual holding company reorganizations and conversions from mutual to stock form ("Proposed Regulations"). In Section 5 of the preamble to the proposed regulations, the OTS invites comment to the proposed regulations, including, among other things, "How can OTS make the MHC form more attractive?"

Set forth below are the comments of Wake Forest Bancorp, M.H.C. ("Bancorp"), Wake Forest Bancshares, Inc. (the "Company") and Wake Forest Federal Savings and Loan Association (the "Association") (collectively "Wake Forest") to the Proposed Regulations.

I. General

In the overview to the Proposed Regulations, the OTS noted that it "encourages consideration of the mutual holding company (MHC) alternative" for mutuals that elect to convert to stock form and that it believes that the "MHC structure retains the benefits and essential nature of the mutual charter, while providing greater access to capital markets." As a mutual holding company with no present plans to convert to a full stock form of organization, Wake Forest agrees with the OTS that

the mutual holding company form of organization should be a viable and competitive business entity and applauds the OTS' attempt to promote the MHC form as a viable alternative to full conversion. We also note that the OTS appears to be taking the position that it considers mutuality to be a better chartering option than stock form of organization. Whether or not the OTS' preference for mutuality is appropriate, we recognize that the OTS has legitimate concerns about the ability of institutions to manage their capital and the pressures of being a public company. In fact, these concerns played a major role in Wake Forest's decision to reorganize into a mutual holding company form of organization rather than undertaking a full conversion. However, for the reasons discussed more fully below, in many respects, this decision has had an adverse impact on Wake Forest's ability to attract and retain qualified personnel though stock compensation and, as a result, has placed Wake Forest at a competitive disadvantage with other institutions.

II. Stock Benefit Plans

A. Background

On April 3, 1996, the Association completed its reorganization into mutual holding company form (the "Conversion"). Pursuant to the Conversion, the Association (i) exchanged its federal mutual savings and loan association charter for a federal stock savings and loan association charter and (ii) formed the MHC, a federally chartered mutual holding company which owned in excess of 50% of the common stock of the Association. In connection with the Conversion, the Association sold shares of its common stock to certain depositors of the Association and the Association's Employee Stock Ownership Plan ("ESOP"). Because of the Association's relatively small asset size (\$55.1 million at the time of Conversion) and its decision to undertake a mutual holding company formation and not a full conversion, the Association issued only 1,213,448 shares of common stock in the Conversion and raised only \$5,150,000 in gross proceeds in the Conversion.

On May 7, 1999, the MHC completed a reorganization into a two-tier mutual holding company format by establishing the Company as a stock holding company parent of the Association (the "Reorganization"). As of the date of this letter, the Company is majority owned (approximately 51%) by the MHC. As part of the Reorganization each outstanding share of the Association's common stock was converted into one share of common stock par value \$.01 per share of the Company and the holders of the Association's common stock became the holders of all the outstanding shares of the Company's common stock. Accordingly, as a result of the Reorganization, the Association's minority shareholders became minority shareholders of the Company.

The Wake Forest Federal Savings & Loan Association 1997 Stock Option Plan ("Option Plan") was adopted by the Association and approved by its shareholders at the 1997 Annual Meeting. In accordance with OTS regulations, the Association reserved 10% of the shares issued to persons other than the MHC, or 54,000 shares of common stock ("Option Shares"), for issuance upon the exercise of options. As of January 22, 1997, all options available for grant under the Option Plan had been granted to all directors, officers and employees of the Association.

Similarly, the Wake Forest Federal Savings & Loan Association 1997 Recognition and Retention Plan (the "RRP") was adopted by the Company and approved by its shareholders at the 1997 Annual Meeting. The Association was permitted to allocate 4% of the shares issued to persons other than the MHC, or 22,248 shares of common stock, for awards under the RRP. As of January 22, 1997, all restricted stock available for award under the RRP had been granted to all directors, officers and employees of the Association.

It is important to note that no person received more than 13,500 options or more than 5,562 restricted stock awards and that each non-employee director received 2,315 options and 954 restricted stock awards under the plans. In addition, all officers and employees of the Association received option and restricted stock awards under the plans. However, despite the relatively small scale of stock compensation, under current OTS regulations, the Company may not grant additional options or restricted stock awards to employees, officers and directors without undertaking an offering to all eligible depositors or a full conversion.

To address potential supervisory concerns related to the increased management needs of a publicly held company, Wake Forest appointed additional officers and directors to strengthen its management team. More specifically, in February and August of 1997, the Company nominated William S. Wooten and Rodney M. Privette, respectively, to serve on the Board of Directors of the Company. In addition, on December 1, 1998, the Company hired Robert C. White to serve as its Chief Financial Officer. The Company also recently hired Billy B. Faulkner as a Vice President on October 1, 2000. As discussed above, no additional stock options or RRP awards are available for grant to these persons or other similarly situated persons under the Company's stock benefit plans. As discussed above, under current OTS regulations, the Company could not grant additional stock options or RRP awards without conducting an additional stock offering to its depositors in a second step transaction. Because the Company does not wish to raise excess capital solely to increase stock compensation available to its directors, officers and employees, it is unable to offer stock based compensation to attract or retain officers, employees or directors, such as Messrs. White, Wooten, Privette and Faulkner. This places the Company at a significant competitive disadvantage relative to fully converted institutions and other publicly traded companies.

B. Comments

1. The OTS Should Place MHC's on Equal Footing with Fully Converted Institutions with Respect to Stock Compensation Plans.

Wake Forest applauds easing of restrictions on the ability of MHC's to grant stock compensation to eligible employees, officers and directors in the Proposed Regulations and believes that these proposals are consistent with the OTS' stated goal of making the MHC form of organization "a more suitable long-term alternative to full conversion." More specifically, we agree with expansion of Section 575.8(b) which allow newly converted MHC's to offer management benefit plans or stock option plans as if minority shareholders held 49% of the stock, provided that the MHC retains majority control. Also, we support proposed Section 575.7(d)(7) which would

allow the issuance of additional stock benefits without requiring an additional stock issuance to all categories of subscribers. By providing mutual holding companies with the flexibility to issue additional stock compensation to its directors, officers and employees without undertaking a stock offering, the proposed regulation alleviates the pressure to raise excess capital through a stock offering to maximize stock compensation.

However, even under these circumstances, the limits placed on stock compensation by mutual holding companies place MHCs at a competitive disadvantage to fully converted entities. Because an institution's need to offer a competitive compensation package is not related to the form of stock organization it chooses, we recommend that an MHC be permitted to offer equity compensation opportunities as fully converted institutions during their first year of public ownership — that is, with percentage limits applied to the whole of its outstanding shares, rather than a theoretical maximum 49% public float. It permits all MHCs the flexibility to offer some equity compensation whether or not it offers shares of its stock in a public offering and, if it does, without regard to the size of the offering. This alleviates pressure which MHCs might otherwise feel to raise excess capital through a stock offering in order to maximize its ability to offer competitive equity compensation programs. In short, if the OTS wishes to promote mutuality and give preference to the MHC form of organization as the preamble suggests, it should consider placing fully converted institutions and MHC on equal footing with respect to stock compensation plans.

2. The OTS Should Permit MHCs to Fund Stock Benefit Plans with Repurchased Stock.

Although Wake Forest believes the amendments to Section 575.7(d)(7) and 575.8(b) are a step in the right direction, it is not clear that they address Wake Forest's particular concerns regarding the granting of additional stock compensation to its new directors, officers and employees. Wake Forest requests that the OTS clarify that these provisions would permit MHCs that have issued 49% of their stock to the public to issue stock compensation above the regulatory thresholds by using treasury stock repurchased through duly authorized stock repurchase plans. Wake Forest believes that such clarifications would permit it to issue stock compensation to the two additional officers and two additional directors and to other similarly situated employees, officers and directors in the future. The amendment will also permit Wake Forest to increase the stock compensation of its current employees, officers and directors if the Board of Directors deems appropriate. In doing so, Wake Forest's ability to attract and retain quality personnel will be greatly enhanced and its competitive disadvantage relative to other entities will be reduced.

3. Acceleration of Vesting.

We note that Section 563b.500(a)(12) of the Proposed Regulations liberalizes the accelerated vesting of benefits to permit accelerated vesting upon a change of control of the converted savings association in addition to accelerated vesting for disability or death. Wake Forest agrees with this revision and believes that accelerated vesting should also be permitted in the event

of retirement that occurs at least one year after the conversion. Wake Forest believes that the converted savings association is in the best position to decide on the characteristics of the plan necessary to achieve corporate objectives and to attract and retain individuals of outstanding competence. The OTS' current vesting standards give rise to unintended and detrimental influences on employees, officers and directors to whom equity compensation awards are granted. Under current regulations, it is impossible to grant any award, of any size, under a plan implemented within one year after a conversion that has less than a 5-year vesting schedule. As a result, individuals who are within 5 years of a customary retirement date must either be excluded from participation in these plans — a problematic approach under prevailing age discrimination laws — or be granted an award under which they are penalized financially if they do retire at the customary time. Wake Forest believes that it is detrimental to institutions to require that they operate under a regulatory scheme which has the effect of interfering with customary and prudent age-related succession planning.

These concerns are not fully addressed by an institution's ability, with shareholder approval one year after conversion, to add retirement-related vesting to grants made previously. Under current accounting standards, the typical grant of an option with a fixed exercise price at the fair market value of the stock on the date of grant will not result in compensation expense for the issuer of the option. However, under recent changes to the accounting standards we understand that a "modification" or amendment to an existing option would result in periodic compensation expense charges. Accordingly, while the OTS regulations would allow a newly converted institution to amend its plan to provide accelerated vesting at retirement after the first anniversary of its conversion, in so doing the institution would suffer unexpected accounting expenses that are not customary, producing investor confusion in interpreting financial statements. Historically, since shareholders have always approved this provision when put to a shareholder vote, a special meeting to approve amendments to the plan is an unnecessary expense. We suggest as an alternative that the plan provide for accelerated vesting for retirement with a provision that individuals who retire prior to one year following conversion cannot benefit from such provision.

II. Dividend Waivers

The OTS changed its policy regarding the ability of a mutual holding company to waive dividends in the interim rule (65 FR 43088) (the "Interim Rule") published simultaneously with the Proposed Regulations (65 FR 11361, 11363 (March 9, 1998)). This policy was enforced by requiring dilution of the minority shareholders upon their exchange of shares in a second step conversion, which the OTS states it has done only to the extent of waivers of excess or special dividends. (65 FR 43088). Wake Forest believes that the Interim Rule is consistent with the OTS' goal of promoting the viability and competitiveness of MHCs.

III. Stock Repurchases

Section 563b.3(g)(3), as revised in the Interim Rule, eliminates restrictions on stock repurchases by converted savings associations after the first year following conversion. Stock repurchases in the first year are still subject to OTS approval and such approval may only be given in "extraordinary" circumstances. Wake Forest believes that an MHC should not be subject to any additional OTS approval or oversight with respect to share repurchases after the first year following conversion. By that time, shareholders have an expectation of the institution's flexibility to respond to market conditions by managing capital, including engaging in stock repurchase programs, in order to enhance shareholder value. In addition, management will have had at least one year of experience in analyzing market and economic conditions and should be permitted to decide to repurchase stock that it believes to be undervalued in the market to send a positive message of confidence in the institution's future. In addition, the market will expect the institution to continue to repurchase shares consistent with past practice when and if the board deems it advantageous. Any loss of flexibility in the institution's ability to manage its capital would be detrimental to the performance of its stock in the market as well as the ability of the institution to attract investors should it desire to engage in a second-step transaction.

IV. Conclusion

We hope that the comments of Wake Forest set forth in this letter are helpful in the OTS efforts to improve and streamline the conversion and MHC reorganization regulations. The officers of Wake Forest would greatly appreciate the opportunity to discuss these comments with the OTS staff. Please call Anna Sumerlin at (919) 556-5146 or me at (202) 347-8400 if you have any questions regarding these comments or require additional information.

Very truly yours,

THACHER PROFFITT & WOOD

By: 