LAW OFFICES
SILVER, FREEDMAN & TAFF, L.L.P.
A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
1100 NEW YORK AVENUE, N.W.
WASHINGTON, D.C. 20005-3934
(202) 414-6100
WWW.SFTLAW.COM

SIDNEY J. SILVER, P.C.
ROBERT L. FREEDMAN, P.C.
BARRY P. TAFF, P.C.
JAMES S. FLEISCHER, P.C.
JEFFREY M. WERTHAN, P.C.
KIP A. WEISSMAN, P.C.
MARTIN L. MEYROWITZ, P.C.
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MICHAEL S. SADOW, P.C.
NANCY M. STILES, P.C.
BETH A. FREEDMAN
CRAIG M. SCHEER
MICHAEL A. TROY*
MICHAEL R. GARTMAN

*NOT ADMITTED IN D.C.

TELECOPIER NUMBER
(202) 682-0354

OF COUNSEL
JOHN F. BREYER, JR.
LAWRENCE J. EISENBERG
E. PRESTON RUTLEDGE
JOHN B. SELMAN*
JAMES W. LANCE*
MARTIN J. O'RIORDAN*
DANIEL C. HOLDGREIWE*

WRITER'S DIRECT DIAL NUMBER
(202) 414-6100

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VIA E-MAIL AND HAND DELIVERY

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Attention: Docket No. 2000-57

Dear Sir or Madam:

This letter sets forth our comments on the notice of proposed rulemaking on mutual to stock conversions and other matters published on July 12, 2000 at 65 Federal Register 43092 (the "Proposed Rules"). This firm represents many state and federal mutual and stock savings associations, savings banks and their holding companies, both in stock form and MHC form. We have reviewed the materials submitted by RP Financial, Inc. in response to the Proposed Rules, and we believe that RP Financial's data presents an accurate picture of the industry and conversions to stock form. The RP Financial material clearly demonstrates that newly converted thrifts cannot meet the unrealistic and unfair "needs" test of the Proposed Rules.

The following features of the Proposed Rules offer some valuable improvements to the regulation of mutuals:

- Training examiners on compensation issues, permitting mid-tier subsidiaries of MHCs to offer stock benefit plans as if 49% of the stock were held by outsiders, and the revision of policy on stock benefit plans adopted in connection with a conversion will enhance the ability of mutual savings associations and MHCs to compete for qualified management.

- Exploring new ways for mutual savings associations and MHCs to raise capital offers the potential to broaden their options for increasing capital and structuring acquisitions.

- Not requiring a members' vote for a conversion to MHC or mid-tier form will facilitate such transactions, thereby giving management more flexibility, while still protecting members by retaining their voting rights at the MHC level.

However, the proposals to change and codify the business plan requirements are seriously flawed in a number of respects, as explained further below, and should not be adopted. They would impinge on the principal of freedom of form of association for savings associations, which Congress has always respected, and impose inappropriate burdens and restrictions on converting institutions.

Finally, the OTS should not pursue the notion of special dividends by mutuals seeking to return excess capital to their communities. "Free distributions" of various kinds in connection with conversions were tried early in the history of conversions and gave rise to abuses and unfairness.[1] It has long been settled that mutual members, who had the best claim of any of the potential claimants to the equity of a mutual association, are not entitled to a distribution of equity.[2] To introduce dividends to return capital to the regulatory scheme for mutuals, even as an option for management, would subject management to pressures for distributions that would drain capital from the association, distract management from the operations of the association and even potentially lead to pressure for conversions. These are precisely the types of pressures and distractions the OTS has said that it wants to prevent.

Freedom of Form of Association is the Historical Basis for Mutual to Stock Conversions

Modern mutual to stock conversions are based on legal authority dating from 1974.[3] The statutes and regulations authorizing conversions have always been based on allowing freedom of form of association for savings associations.[4] Section 402(j) of the National Housing Act, as in

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[1] See § 7.01[4] Williams, Julie L., *Savings Institutions: Mergers, Acquisitions and Conversions* (hereafter, "*Williams*").

[2] The premise of free distributions in connection with conversions was rejected by the Federal Home Loan Bank Board. See 59 Fed. Reg. 61247, 61255 n. 20 (November 30, 1994); 39 Fed. Reg. 9142 (March 7, 1974).

[3] P.L. 93-495, 88 Stat. 1502 (1974); S. Rep. No. 93-902, June 4, 1974 and House Conf. Rep. No. 93-1429, October 4, 1974; regulations of the Federal Home Loan Bank Board published at 39 Fed. Reg. 9142 (March 7, 1974).

[4] Even in the earlier, troubled history of conversions, dating from 1948, freedom of form of association was the basis for allowing conversions. "...[A]ny association chartered as a Federal savings and loan association ...may convert itself into a State institution upon an equitable basis, subject to approval, by regulation or otherwise, by the Federal Home Loan Bank Board and by the Federal Savings and Loan Insurance Corporation...." third unnumbered paragraph of § 5(i) of the HOLA, as amended by Act of July 3, 1948, ch. 825, § 1, 62 Stat. 1239 12 USC § 1464(i)(1946, Supp. 5 1947-52) (the "Act of 1948"). S. Rep. No. 1392, May 25, 1948. There was no authority then to charter federal stock savings associations. The only way for a federal savings association to

effect in 1974, and the 1974 conversion regulations ended free distributions of stock in connection with conversions but otherwise place no restrictions on freedom of form of association.[5] Therefore, it is not surprising that, apart from supervisory cases, in the history of the legislation and regulations governing conversions, approval of conversions involve no consideration of whether an association has a "need" to change the form of its charter or the reasons why its management or members would seek a change to the form of the charter.

The OTS Has Not Justified Restricting Freedom of Form of Association

In the preamble to the Proposed Regulations, the OTS seeks to justify the imposition of restrictions on conversions on the basis of a theoretical, potential loss of "community focus" and cost to the community due to the stock savings association's need to respond to stockholders and the possibility of acquisition by an "out of town" institution. Since the obligations of mutual savings associations to their communities are the same as those of stock savings associations, this concern about "community focus" is unsupported.

Mutual savings associations and stock savings associations have always had the same obligations to serve their communities under federal law, whether under the HOLA or the CRA. The

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convert to stock form was to convert to a state-chartered stock institution. Hearings Before the Committee on Banking and Currency, House of Representatives, 80th Cong., 1st Sess. on H.R. 2798, H.R. 2799, H.R. 2800 and H.R. 3448, May 13 and 14, 1947 ("1947 Hearings"), statement of Mr. Riley at p. 43 that one of the purposes of the bill is to give the shareholders (*i.e.*, the mutual members) the right to say whether they want to have a federal or state charter, and statement of Mr. Fahey, Commissioner, Federal Home Loan Bank Board Administration, that if the majority of the shareholders wish to convert to state charter, they should be able to do so provided there is adequate protection for the other shareholders and the government which insures the savings in those mutuals. See also Leibold, Arthur W. Jr. and Wilfand, Max, "The Conversion Process; Mutual to Stock Savings and Loan Associations, *The Business Lawyer* Vol. 30. No 1, November, 1974 (hereafter, "*Liebold*"), p. 129.

Following the Act of 1948, there were various changes to the statutory authority for charter conversions, including moratoria, and various changes in the regulations governing conversions, but the issues underlying such changes were primarily (though not exclusively) concerns about the rights of members, especially their claims to the net worth of mutual associations, and about inappropriate windfalls of various types.

[5] P.L. 93-100. Section 402(j) of the National Housing Act as originally enacted is quoted in 39 Fed. Reg. 9142 (March 7, 1974). See also authorities cited in notes 1-3 and *Liebold* cited in note 4.

OTS has cited no studies or statistics indicating that stock savings associations do not offer credit and savings products or other products and service, or otherwise fulfill their legal obligations to their communities to the same extent as mutual savings associations, or that converted stock savings associations do not serve their communities to the same extent as they did as mutuals, nor any evidence that the communities served by mutual savings associations are likely to lose opportunities for credit or savings after institutions convert to stock form. Thus, there is no basis to believe that there exists any "cost to the community" or potential "cost to the community" that justifies the restrictions on conversions in the Proposed Regulations.

Gradually, stock institutions have come to prevail in the industry.[6] Many of today's stock savings associations are former mutual savings associations. During all of the history of the increase in stock savings associations as a proportion of the industry, Congress has never seen fit to curb freedom of form of association for thrifts so long as the conversion process protects against abuses. If communities actually were ill-served by decline of mutual savings associations, one would expect some actual evidence of that to be available. But the OTS has not identified any. The generalized notion that "community focus is often lost or diluted" after conversion -- unsupported by even anecdotal evidence-- is grossly inadequate to justify the restrictions on conversions in the Proposed Rules.

The Needs Test Is Unrealistic and Inappropriate

The proposed provisions on business plans require a savings association to project "a reasonable return on equity, commensurate with investment risk, investor expectations, and industry norms...." The Proposed Rules further state that the OTS will not approve a plan that provides for substantial investment in securities, even mortgage securities, except as an interim measure during deployment of conversion capital over the three years following conversion or as part of a properly managed leverage strategy. We assume that a "properly managed leverage strategy" is one that supports the return on equity (ROE) that the OTS emphasizes in the preamble. The business plan may not project stock repurchases, returns of capital or extraordinary dividends. These requirements

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[6] In 1948, three states permitted stock institutions. By the end of 1972, the number of state stock institutions (587) represented 14% of all (4,191) savings associations, and stock institutions held about 21% of the assets of all savings associations. 1947 Hearings at 5; § 7.01[10 *Williams* (cited in note 1) at 7-4. By 1974, 22 states permitted savings associations in stock form. S. Rep. No. 93-902, June 4, 1974, additional views of Sen. Proxmire. The Garn-St Germain Depository Institutions Act of 1982 included an amendment to the HOLA that "liberalizes the Federal chartering option for thrifts by allowing any savings and loan or mutual savings bank to obtain a Federal stock or mutual charter without regard to its present status." S. Rep. No. 97-536, September 3, 1982, at 13. Today, stock institutions represent about 60% of OTS-regulated savings associations, with (according to RP Financial) about 93% of the total assets of OTS-regulated savings associations.

establish a "needs test" for conversion capital that is unprecedented and inappropriate.

The choice of how to deploy capital has always been left to management's discretion. No regulatory requirements based on ROE or opportunities in the institution's market area are imposed by the OTS when a bank or thrift proposes to raise capital in any other way, nor by other banking regulators when an institution proposes to convert to stock form or otherwise raise capital.

Although the OTS has not quantified the "needs test," the data compiled by RP Financial show that about 80% of the thrifts that have converted in the past 10 years would not have met the type of standard the OTS now proposes. These data clearly demonstrate that the test is unrealistic.

Moreover, regardless of what level of ROE is established as adequate for purposes of the "needs test, the test places the OTS in the position of passing judgment on what is an acceptable rate of return in the market over a three year horizon. This is not an appropriate function for a regulator. The OTS has no expertise in predicting market demands for ROE, and its proper concern is essentially safety and soundness, not ROE. It is unprecedented for a banking regulator to concern itself about ROE so long as a depository is safe and sound and has sufficient capital for its operations.

The "needs test" and the requirement for a business plan that cannot be deviated from without prior approval unduly restrict management. In order to meet the business plan requirement, management must propose a scheme for deploying capital. Certain uses of capital cannot be projected far in advance. For example, management cannot make reasonable assumptions about the costs of and opportunities for acquisitions over the three year period covered by the business plan. The Proposed Rules would restrict management's ability to pursue acquisitions after conversion by requiring prior approval for deviation from the business plan. On the face of the Proposed Rules, an acquisition by a holding company that would otherwise require no regulatory approval would be subject to prior approval if it deviated from the business plan, and an acquisition that requires regulatory approval to consummate, such as an acquisition of another depository institution, would be subject to prior approval before the institution could enter into an agreement. These restrictions would impose burdens on management not faced by other thrifts and banks and their holding companies.

The requirement for prior approval of deviations from the business plan interferes with the independence of management. So long as a thrift is financially healthy, operating consistently with safety and soundness principles and meeting its legal obligations such as the CRA and the QTL test, there is no basis for the OTS to have prior approval over management decisions for the bank or its holding company beyond the present requirements for approvals and notices (such as acquisitions of institutions, thrift operating subsidiaries and service corporations). In addition, this new thrust toward extended regulatory control over management decisions essentially takes away from newly converted institutions the benefit of two recent regulatory changes -- the recent rule change

permitting stock repurchases after the expiration of one year following conversion and the revised rules on capital distributions, under which capital distributions for a calendar year that are up to the amount of net income for the year to date plus retained income for the preceding two years are routinely permitted for well capitalized savings associations. Both of these would be unavailable for a newly converted association that must abide by its business plan, in which it cannot project such returns of capital.

The Needs Test Will Have Substantial Negative Effects

The burdens imposed by the needs test and the requirement to follow the business plan unless deviations are approved will have a number of negative effects. These aspects of the Proposed Rules would:

- Encourage institutions to consider conversion to state savings banks to avoid OTS jurisdiction over their conversions, and discourage the conversion of credit unions to federal mutual savings associations.

- Discourage the formation of mutual holding companies (contrary to the OTS's express intention of encouraging MHCs). Rather than risk having to overcome the hurdles set by the Proposed Rules a second time if an MHC elects a second stage conversion, some institutions will elect a full conversion instead of a conversion to MHC form.

- Influence savings associations to propose more risky investments than they would otherwise choose, in order to achieve a ROE at a level that converting thrifts generally have not met in the past, as demonstrated by the RP Financial data.

- Limit the opportunities for mutual savings associations to grow through acquisitions, and, since mutual savings associations cannot merge with stock savings associations, reduce the opportunities for stock savings associations to grow through acquisitions.

In addition, the prospect of a need for regulatory approval for decisions that are entirely within management's discretion for banks and other types of companies will seriously detract from the attractiveness of thrift stock When the OTS adopted the requirement for a business plan in connection with conversions, it clearly stated that allocation of conversion proceeds is "largely a matter for discretion of the converting association."[7] The Proposed Rules offer no reason for the major policy change to the requirement for prior approval for a material deviation from a business plan. No standards are offered for approval of a proposed deviation. Under the Proposed Rules,

[7] 59 Federal Register 61247, 61258 (November 30, 1994).

such approval is wholly within the OTS's unfettered discretion. Potential purchasers of thrift stock will be deterred from investing when they know that thrift management does not have the same freedom to make decisions as other companies.

Alternatives

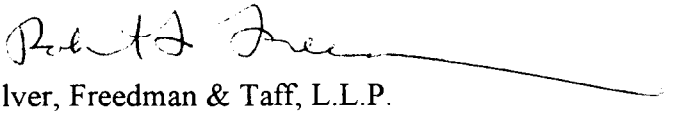
Rather than limit opportunities for raising capital through conversions, the OTS could assist converted institutions in achieving full deployment of conversion capital in a prudent manner by means of the provisions already set forth in 12 CFR § 563b.3(i)(3). The Proposed Rules clearly signal an intention by OTS to scrutinize more closely proposals that require approval under § 563b.3(i)(3).

One of the most critical problems facing the management of newly converted thrifts is the potential for pressure from professional dissident shareholders, who purchase conversion stock with the intent of forcing a sale shortly after conversion before the institution has had a reasonable opportunity to deploy the conversion capital. The OTS should strengthen § 563b.3(i)(3) as a shield against such pressures by adopting amendments to the conversion regulations that would bar approvals under § 563b.3(i)(3) for proposals to acquire newly converted thrifts that result from pressures from professional dissident shareholders who are hostile to management and extend the protection of § 563b.3(i)(3) for five years rather than three years.

To improve the attractiveness of the MHC option, the OTS could amend the regulations to permit mid-tier holding companies to exchange their stock in acquisitions without a requirement to make an offering to depositors. This would enhance the opportunities for MHCs to grow.

We appreciate your consideration of our comments.

Yours truly,



Silver, Freedman & Taff, L.L.P.