

From: Hurwitz, Evelyn S on behalf of Public Info
Sent: Tuesday, October 10, 2000 5:09 PM
To: Gottlieb, Mary H
Subject: FW: 12 CFR Parts 563b and 575

-----Original Message-----

From: cir@world.std.com [mailto:cir@world.std.com]
Sent: Tuesday, October 10, 2000 4:39 PM
To: public.info@ots.treas.gov
Subject: 12 CFR Parts 563b and 575

RALPH NADER
CENTER FOR INSURANCE RESEARCH

October 10, 2000

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

By Mail and

Re: Attention Docket Numbers 2000-56 and 2000-57

Dear Sir or Madam:

We are writing to oppose both the "interim final rule" and proposed rules published in the Federal Register on July 12, 2000, 12 CFR Sec. 563b and 575. We urge the immediate and indefinite repeal or postponement of the adoption of these rules until changes are made to protect the interests of mutual thrift depositors. These new rules will result in permanent and irreparable harm to millions of depositors nationwide and permit excessive executive enrichment. Because the new rules were developed on a "listening tour" of mutual bank executives, without depositor or consumer input, we request that any future rule changes be developed with input solicited from consumers and consumer advocates and not just from representatives of the mutual banking industry.

The new provisions on Stock Repurchases (section A below), Dividend Waivers for Mutual Holding Companies (section B below) and lifting limits on insider stock options (section C below) within the interim final and proposed rules are particularly detrimental to depositors. The provisions provide for increases in management compensation, which in turn creates new conflicts of interest as directors and officers become major shareholders while at the same time stockholders benefit from dividend waivers and stock repurchases approved by those same officers and directors. These issues are discussed further below.

A. Stock Repurchases Should Be Restricted

The interim final rule regarding stock repurchases applies to both MHC and full conversions and will "eliminate restrictions on stock repurchases by converted savings associations after the first year following conversion."

(See § 563b.3(g)). This change is in the interests of management and stockholders, but not depositors. Stock repurchases increase the price of stock and decrease the amount of shares in circulation. Unfortunately, the cost of this price increase is borne by the bank itself when, for example, the stock buyback is at a higher price than the stock was initially sold for in the initial public offering. Such a buyback may boost the bank's cost of capital, requiring it to seek investments with higher returns. This in turn leads to an inevitable shift from small residential and business loans to loans for larger businesses, pushing a converted company further away from the fundamental mission of a mutual bank, a push accelerated by the self-interest of stockholding directors and officers.

Two specific groups benefit from stock repurchases - stockholders and management. Raising the stock price has an immediate and positive result for stockholders; it raises the value of their holdings. Of course, management benefits as stockholders and through "performance" incentive plans that provide directors and officers with options or other benefits if the company's share price rises to certain thresholds. We urge the OTS to maintain the current three year percentage restrictions to prevent the overselling of stock in initial public offerings.

B. Dividend Waivers for Mutual Holding Companies Should Not be Permitted

The interim final rule at § 575.11(d)(3) would allow self-interested directors and officers of a mutual bank that was converted into a mutual holding company (MHC) to waive the receipt of dividends paid to the MHC by the stock bank subsidiary (the converted mutual bank). If waived, such dividends would remain in the stock subsidiary thus providing additional "free" capital to the stock company, capital that can be invested and utilized for the benefit of the subsidiary's shareholders. Thus, waivers of extraordinary dividends by the MHC allow the shareholders (includes management) to benefit at the direct expense of the depositors who receive no share of profits from the bank. This provision of the rule is only the most obvious of the thinly veiled provisions which seek to redistribute profits from depositors to shareholders and self-interested insiders who make all the decisions. Needless to say, the final interim rule contains no standards to prevent the obvious conflicts of interest from occurring because it is the very intent of the rules to facilitate the conflict - at the behest of mutual bank management who influenced the drafting of the rules ex parte and without public hearings.

Obviously, when a converted mutual bank declares a dividend for shareholders it should also pay dividends to the MHC - the largest voting shareholder - so that the MHC passes a share of the profits to depositors.

While management already had the authority to waive dividends to the MHC under the previous regulations, the new provision expands the availability of these waivers to include extraordinary dividend payments. As a result, such waivers will become the norm rather than the exception. Furthermore, upon full demutualization, a MHC should be required to compensate depositors for these "lost" dividends payments.

The practice of waiving MHC dividends conflicts with the fundamental nature of mutuality, in which depositors elect the directors and share in the success of the bank. We urge you to strike this provision which only benefits stockholders and does not further the interests of the mutual institution and its depositors. Instead, the OTS should prohibit the waivers of any dividends by the MHC and require that depositors be paid dividends on these profits.

C. Proposed rules for Holding Companies

On the same day the interim final rule was published OTS also requested comments on other potential changes in the rules governing MHC conversions. Our brief comments on the proposed rule alterations follow.

First, one change proposed on page 43096 of the Federal Register eliminates the right of depositors to vote on a mutual bank's conversion to a MHC. Depositor voting rights are an essential part of the mutual structure. Any move to destroy these voting rights represents a shift of control from depositors to management. While the OTS may not know of any mutual bank conversions which were voted down by depositors, at least one recent mutual insurance company demutualization failed to carry the required policyholder vote (Mercer Mutual of Pennsylvania). This proposed alteration would further dilute the rights of depositors and eviscerate the obligations of management to accurately describe the transaction and its benefits for depositors. We urge the OTS to adopt rules that require management to make full disclosure in simple terms, of the conflicts of interest and self-interest that often drives such conversions, as well as other more complete disclosures. The proposed rules move in precisely the wrong direction, toward no disclosure at all.

Second, not only should the OTS clarify and codify current rules on the establishment of charitable institutions in full demutualizations (see proposed § 563b.15), the establishment of such institutions should be mandated for both types of conversions. Following a full demutualization or MHC conversion, the relationship between the bank and its community are fundamentally altered. A charitable foundation should be mandated, provided with 10-25% of the converting bank's assets and stock, and formed with an independent board. The Foundation shares should be voted independent of the bank's input. Only this institution will preserve the community commitments of the former mutual bank when it becomes shareholder driven.

Third, increasing the amount of stock available to option plans for company directors and officers in a MHC is unwarranted (see section II. H of No.

2000-57). By eliminating provisions which limit the total amount of options to a percentage of the stock sold to minority investors, the proposed rule allows insiders to hold a major or controlling interest in the stock and facilitates the use of the MHC structure as a tool for insider control and enrichment. This will encourage conversions for all the wrong reasons and must not be allowed.

Fourth, the proposed rule at § 563b.105 requires fully demutualized holding companies to contribute at least 50% of gross conversion proceeds to the savings bank. The same standard should be applied in MHC conversions. While a 50% contribution mandate is preferable to having none of the new capital left in the bank, regulations should require that all proceeds remain in the bank subsidiary. By allowing holding companies to invest conversion proceeds in non-banking activities, capital which should be used for community development and depositor services will instead be diverted to outside investments.

Fifth, the proposed § 563b.11 mandates ex parte, pre-filing meetings between the OTS and companies preparing to convert. This is remarkable for its violation of the open process mandated for accountable and effective government oversight of corporate transactions. All regulatory proceedings should be open to depositors, consumer advocates and all other interested parties through a public hearing process not private meetings since the agency acts as a decision-maker in approving conversion plans. Given the way these final interim and proposed rules were developed ex parte, and the obvious bias toward management interests contained therein, the public has no assurances that specific transactions will be any fairer.

Finally, the supplementary text accompanying the final interim rules states that the underlying assumption for the rules is that the MHC structure "retains the essential benefits and nature of the mutual charter." We request clarification on exactly what the "essential nature of a mutual" includes. In a MHC, management must run the company for the benefit of all stockholders as a matter of federal law and not just the parent MHC, depositors do not share in the financial success of the bank, and the bank often loses its connection to its community. It is hard to see what elements of mutuality, if any, remain in the converted company. We believe converting to a MHC structure fundamentally changes the nature of an institution, benefiting insiders at the expense of depositors and the community particularly, under the final interim and proposed rules. Management's personal interests are best described in a quote by James Keegan (then a mutual bank executive) in commenting on why mutual conversions occur: "convert to stock, and you, personally, will get rich" (Ada Focer, "Greed," Boston Magazine, Feb. 1992, p.60).

We are greatly concerned about the final interim and proposed rules of the OTS. Rather than making stronger rules which preserve mutuality and protect depositors, the OTS is providing incentives for management to place their own vested interests over those of depositors at every turn. Only six years after criticism by Congress forced regulatory agencies to draft

stronger conversion regulations, the OTS is again looking for ways to loosen conversion requirements at the behest of insiders to personally empower and enrich bank executives while leaving thrift depositors with little or nothing to fend with for themselves.

We urge the Office of Thrift Supervision to suspend the interim final rule and reject the proposed rules for the reasons discussed above. As currently drafted, the new rule and suggested changes are detrimental to depositor interests and serve only as tools to further increase management compensation and stockholder profits at the expense of mutual institutions.

Sincerely,

Brendan Bridgeland, Director
Jason Adkins, Legal Counsel
Center for Insurance Research

Ralph Nader
P.O. Box 19367
Washington, DC

20036

1130 Massachusetts Avenue

(202) 387 -

8030

Cambridge, MA 02138
(617) 441 - 2900