

# KEARNY MHC

VIA E-MAIL

October 24, 2011

Ms. Jennifer J. Johnson  
Secretary of the Board  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Attention: Docket No. R-1429; RIN No. 7100 AD 80

Re: August 11, 2011 Interim Final Rule: Savings and Loan Holding Companies  
Provisions of Regulation MM Affecting Dividend Waivers by Grandfathered  
Mutual Holding Companies

Dear Ms. Johnson:

Kearny MHC, Fairfield, New Jersey hereby submits comments to the Board of Governors of the Federal Reserve System ("Federal Reserve Board") on the provisions of the Regulation MM, as included in the referenced Interim Final Rule ("IFR") issued by the Federal Reserve Board on August 11, 2011, relating to the waiver of dividends by mutual holding companies ("MHCs") that are subject to grandfathered treatment as to dividend waivers ("Grandfathered MHCs") under the provisions of Section 625 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203 (the "Dodd-Frank Act"). This comment letter addresses the provisions of the IFR set forth at 12 C.F.R. Section 239.8(d).

## EXECUTIVE SUMMARY

As discussed herein with greater detail, we are very concerned that the IFR's requirement of an annual vote of members of the MHC as a pre-condition to the MHC's waiver of dividends on the stock it owns in its subsidiary mid-tier holding company, Kearny Financial Corp. ("Kearny Financial"), will require the MHC either to incur a significant expense to seek to obtain the annual member vote or, to discontinue dividends to the mid-tier company's minority stockholders. The imposition of this requirement by the Federal Reserve Board, unless reversed, will disrupt the established capital management strategy of the mid-tier company, which includes the payment of a small quarterly dividend to the minority stockholders of the mid-tier company for a period of 19 consecutive quarters. This recurring dividend has provided a modest return on investment to the company's minority stockholders.

We believe that Regulation MM's requirement of an annual vote of members of Grandfathered MHCs is contrary to Section 625 of the Dodd-Frank Act, is inconsistent with the Charter and Bylaws of Kearny MHC and interferes with the safe and sound on-going operations

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of the MHC, the mid-tier holding company and the subsidiary insured depository institution (Kearny Federal Savings Bank, referred to herein as the "Bank"). Such annual vote requirement imposes a costly burden on the Grandfathered MHC with no corresponding practical benefits to the interests of the members of the MHC or the safe and sound operations of the Bank. The annual member vote requirement will interfere with the ability of the mid-tier holding company to efficiently provide a modest dividend return to the minority stockholders by making such dividends subject to the additional significant costs associated with a proposed annual vote of members of the MHC to approve the MHC's waiver of dividends or, alternatively, causing the MHC to incur Federal and State income tax liability on the receipt of dividend income paid on the MHC's stock of the mid-tier subsidiary company (in the event that the requirements for a dividend waiver are not met). Further, such regulation might have the consequence of promoting the selection of members of the board of directors of the MHC who do not own stock of the mid-tier subsidiary company rather than the primary criteria being those with the knowledge, skill and service that promotes the safe and sound operation of the MHC and the Bank. For these reasons, we request that this requirement for an annual vote of members of Grandfathered MHCs set forth at 12 C.F.R. Section 239.8(d)(2)(iv) be removed from Regulation MM.

In addition, this letter comments more generally on the provisions of Section 239.8(d)(2) of Regulation MM relating to the form and content of the MHC board of directors resolutions. As set forth below, we feel strongly that the Federal Reserve Board, like the Office of Thrift Supervision ("OTS") before it, should defer to the judgment of the individual boards of directors of Grandfathered MHCs in their determinations of whether a proposed dividend waiver is consistent with such boards' fiduciary duties to the members of their MHCs.

## BACKGROUND

Kearny MHC's mid-tier subsidiary, Kearny Financial, completed its minority stock offering on February 23, 2005. In such offering, public stockholders acquired approximately 70 percent of Kearny Financial's common stock and Kearny MHC approximately 30 percent. Beginning with the quarter ended June 30, 2005, Kearny Financial has paid regular dividends to its minority stockholders each quarter. Kearny MHC has waived the receipt of all such dividends, in each case following the receipt of non-objection from the OTS in accordance with that agency's former regulations at 12 C.F.R. Part 575. In light of such payment of dividends by Kearny Financial and Kearny MHC's waiver of dividends that it had the right to receive prior to December 1, 2009, Kearny MHC qualifies for grandfathered regulatory treatment of dividend waivers pursuant to Section 10(o)(11)(D)(iii) of the Home Owners' Loan Act (the "HOLA"), 12 U.S.C. § 1467a(o)(11)(D)(iii), as added by Section 625 of the Dodd-Frank Act, and is thus a Grandfathered MHC for purposes of Section 239.8(d) of Regulation MM.

COMMENTS ON REGULATION MM'S REQUIREMENTS AFFECTING DIVIDEND  
WAIVERS BY GRANDFATHERED MHCS

- A. The requirement for annual member approval of MHC dividend waivers is contrary to the Dodd-Frank Act, inconsistent with the Charter and Bylaws of Kearny MHC, and contrary to the safety and soundness of Kearny MHC and the Bank.
1. The annual member approval requirement of Section 239.8(d)(2)(iv) is an additional substantive requirement not contemplated by Section 625 of the Dodd-Frank Act.

Section 625 of the Dodd-Frank amended Section 10(o) of the HOLA to set out the rules under which an MHC may waive its right to receive dividends declared by its stock subsidiary. For purposes of Federal Reserve Board review of dividend waiver notices, Section 10(o) of the HOLA distinguishes Grandfathered MHCs from Non-Grandfathered MHCs.

The new Section 10(o)(11)(D) of the HOLA specifies that “[t]he [Federal Reserve] Board may not object to a waiver of dividends” by a Grandfathered MHC if (i) “the waiver would not be detrimental to the safe and sound operation of the savings association” and (ii) “the board of directors of the mutual holding company expressly determines that a waiver of the dividend by the mutual holding company is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company.” Section 10(o)(11)(C) of the HOLA further provides that a dividend waiver notice filed by a Grandfathered MHC shall include a copy of the resolution adopted by the board of directors of such company, “in such form and substance as the [Federal Reserve] Board may determine, together with any supporting materials relied upon by the board of directors of the mutual holding company, concluding that the proposed dividend waiver is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company.”

Although Federal Reserve Board has the authority to set standards for the form and substance of the dividend waiver resolutions to be adopted by the board of directors of a Grandfathered MHC, we believe that the requirement of Section 239.8(d)(2)(iv) of Regulation MM that such resolutions reflect the annual adoption of a resolution by the members of a Grandfathered MHC exceeds the Federal Reserve Board's authority in Section 10(o)(11)(C) of the HOLA. The Federal Reserve Board's authority to determine the “form and substance” of the dividend resolutions adopted by a Grandfathered MHC's board of directors does not, in our view, include the power to impose a separate, onerous condition of requiring an annual member vote which approves the MHC board's determination as a pre-condition of the MHC requesting a waiver of the dividend. If Congress had intended dividend waivers by Grandfathered MHCs to need member approval, it would have included that requirement in the legislation amending the HOLA. Because Congress did not require member approval as an express condition to its authority for dividend waivers by Grandfathered MHCs, a strong negative implication exists that should prevent the Federal Reserve Board from imposing this additional burdensome requirement. Permitting the Federal Reserve Board to require a member vote as a requirement

for approval of the dividend waiver by Grandfathered MHCs would thwart the legislative intent behind the Dodd-Frank Act's grandfathering provisions, and would permit the Federal Reserve Board to act as a super-legislature.

Furthermore, the annual member vote requirement of Section 239.8(d)(2)(iv) cannot be justified as being essential to a Grandfathered MHC board's resolution regarding the consistency of dividend waivers with the board's fiduciary duties to the members. We believe that such a board resolution can be based on a variety of factors and, furthermore, that Congress's recognition of a Grandfathered MHC board's discretion in the matter of its fiduciary duties to the Grandfathered MHC's members is implicit in Section 10(o)(11)(D) of the HOLA.

2. The practical effect of Section 239.8(d)(2)(iv)'s annual member approval requirement is to terminate all future dividend waivers by Grandfathered MHCs and, as such, is contrary to the clear intent of the Dodd-Frank Act's grandfathering provisions.

The clear Congressional intent behind the grandfathering provisions of Section 625 of the Dodd-Frank Act was to permit Grandfathered MHCs to continue to waive dividends in accordance with the past practice and procedures of the OTS. We believe that Congress was aware of the Federal Reserve Board's historic opposition to dividend waivers and included grandfathering provisions in Section 625 to ensure that Grandfathered MHCs would continue to be able to waive dividends following the Transfer Date under the same rules as before. This Congressional intent is shown both (a) by the provisions of HOLA Section 10(o)(11)(D), referenced above, providing that the Federal Reserve Board "may not object to a waiver of dividends" by a Grandfathered MHC that satisfies certain minimal requirements, and (b) by Section 10(o)(11)(E) of the HOLA, which continues for Grandfathered MHCs the former OTS rule that waived dividends would not be considered in determining the appropriate exchange ratio in the event of a full stock conversion of the organization. In view of the Dodd-Frank Act's specific protection of the dividend waiver authority of Grandfathered MHCs, we believe it to be clear that a regulation which makes it unduly burdensome for such companies to waive dividends in the future is inconsistent with the intent of Congress.

The net effect of the Federal Reserve Board's imposition of an annual member vote to approve dividend waivers would be to eliminate dividend waivers by Grandfathered MHCs altogether. This conclusion results from the extremely high cost for a mutual holding company to obtain a vote of a majority of the outstanding votes of members without the use of "running" proxies (proxies that have been in place for more than a one year period). We have been informed by our investment bankers and our legal advisors that the total cost of obtaining such vote for an organization our size (assuming that it could be obtained) is estimated to be approximately \$250,000 annually. This total includes legal fees, printing expenses, mailing costs and proxy solicitation expenses. It is our conclusion, and we assume that other Grandfathered MHCs will reach the same conclusion, that an annual expenditure of such size represents a significant expenditure by the Grandfathered MHC and constitutes an unnecessary regulatory burden which is beyond the Congressional intent of Section 625 of the Dodd-Frank Act. This

expense represents approximately ten percent (10%) of all dividends paid by Kearny Financial to its minority shareholders during the past year. While we assume that the Federal Reserve Board was unaware of the excessive cost of conducting a member approval vote for a dividend waiver proposal, the effect of Section 239.8(d)(2)(iv)'s requirement will be to eliminate, or at the very least to strongly discourage, continued dividend waivers by Grandfathered MHCs. Frankly, requesting that a majority of members vote to approve a matter for which they likely have no particular interest or direct or indirect stake in the outcome appears to be an additional procedural step being imposed upon Grandfathered MHCs by the Federal Reserve Board which is both unnecessary and an unreasonable impediment to Grandfathered MHCs' continued ability to waive dividends under the authority of Section 625 of the Dodd-Frank Act.

One possible consequence of the inclusion of the member vote requirement as a precondition for a Grandfathered MHC to apply for a dividend waiver would be to promote the appointment of directors of the MHC who do not have an equity ownership in the mid-tier subsidiary company. The result could be a board of directors comprised solely of directors who do not own stock of the mid-tier subsidiary company as a way to avoid the time and expense of obtaining a member vote. Such a result appears inconsistent with bank regulatory policy and investor and market preferences that directors of any companies or banks have an equity interest in the entities for which they are responsible to operate safely, soundly and profitably. We do not understand why the Federal Reserve Board would promote a policy adverse to such common practice where members of the Board of Directors are encouraged to maintain an equity investment in the companies they serve as directors. We would argue it is not in the best interest of the Federal Reserve Board to promote a policy adverse to such common policies and preferences. We note in this regard that the regulations of both the OTS and the OCC require directors of stock associations and national banks to own a certain minimum number of shares of stock in order to qualify as directors of those institutions.

Accordingly, we submit that Section 239.8(d)(2)(iv)'s annual member approval requirement is, in effect, contrary to the Congressional intent expressed in Section 625 of the Dodd-Frank Act and that it should be deleted from Regulation MM.

3. The annual member approval requirement is inconsistent with the Charter and Bylaws of Kearny Financial Corporation, MHC.

In accordance with Kearny MHC's Federal Mutual Holding Company Charter (which is essentially the same as the model charter for federal mutual holding companies), the management and affairs of the mutual holding company shall be under the direction of the board of directors. In accordance with Kearny MHC's Bylaws, the board of directors shall have the power to exercise any and all of the powers of the MHC not expressly reserved by the Charter to the members. In that it is not an expressed authority under Kearny MHC's Charter or Bylaws that the members should have the authority to vote to approve either (1) any dividend waivers authorized by the mutual holding company board, or (2) any direct or indirect compensation of the MHC's directors, nor is it a requirement detailed under Section 625 of the Dodd-Frank Act, it appears that the Federal Reserve Board's proposed requirement that the members must annually

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approve the Grandfathered MHC's board action to waive dividends as a pre-condition to the Federal Reserve Board's consideration of such a dividend waiver request is inconsistent with the existing Charter and Bylaws of Kearny MHC. We note that such governing documents were previously approved by a member vote as part of the approval of the mutual holding company reorganization.

4. The annual member approval requirement is contrary to the safety and soundness of the MHC and the Bank.

As noted previously, the costs of obtaining the MHC member vote will be a significant and recurring annual expense. Because the source of funds for the payment of such expenses will ultimately be dividends from the Bank, every dollar paid in connection with the annual member vote will cause the capital of the Bank to be reduced in the same amount. In the alternative, if the MHC were either unable to obtain the requisite vote of members as a pre-condition to obtaining approval to waive dividends, or the MHC elected not to seek such member vote because of the excessive expenses associated with seeking such vote, then any dividend income paid by the mid-tier subsidiary company to the MHC would be subject to Federal and State income tax liability and would thereby reduce the capital strength of the mid-tier subsidiary company and the Bank. In either case, the payment of such expenses by the MHC would diminish the ability of the MHC and the mid-tier company to serve as a source of strength to the Bank and would adversely affect the capital position of the organization.

In addition, as noted above, if the MHC Board were to determine that in order to permit the MHC Board to have greater flexibility in determining whether or not to elect to waive dividends and to avoid the requirement for an annual member vote, the MHC Board could select directors who are not stockholders of the mid-tier subsidiary company. We do not understand why the Federal Reserve Board would promulgate regulations that might influence the selection of MHC Board members who are not stockholders of the mid-tier subsidiary company in that , and we do not understand how such regulations serve to promote the safe and sound operations of the MHC and the Bank. In fact, such regulations might, in fact, create a situation where the interests of the MHC Board members and the Board members of the mid-tier subsidiary company and the Bank are potentially at odds, with the MHC Board actions not actually focused primarily on promoting the safe and sound operations of the MHC and the Bank. For example if no MHC Board members have any equity ownership in the mid-tier subsidiary company, such MHC Board might determine that undertaking a full stock conversion of the MHC structure is adverse to their interests in that the MHC Board would be dissolved fromin such a transaction. Such determination by an MHC Board could be an insurmountable impediment to the mid-tier subsidiary company if it the company were to determine to undertake a full stock conversion transaction, but such transaction is unable to obtain the approval of the MHC Board.

B. The Federal Reserve Board should defer to the Boards of Directors of Grandfathered MHCs regarding their fiduciary duties to the members.

While we recognize the authority of the Federal Reserve Board under Section 10(o)(11)(C) of the HOLA to determine the “form and substance” of the resolutions by a Grandfathered MHC’s board of directors approving dividend waivers, it is our belief that the Federal Reserve Board, in keeping both with its history of non-interference with decisions of bank holding company boards of directors and with the precedent of the OTS regarding MHC dividend waivers, should give deference to the determinations of a board of directors of a Grandfathered MHC as to the consistency of a dividend waiver with the board’s fiduciary duty to the members.

The uniform practice of the OTS was not to object to dividend waivers by boards of MHCs provided that dividends paid to the mid-tier companies’ minority shareholders did not exceed net earnings of the mid-tier subsidiary company on an ongoing basis. With that exception, which is based on safety and soundness considerations, the OTS did not challenge the judgment of MHC boards of directors as to the waiver of dividends. We believe that the OTS’s position on dividend waivers to have been correct, as dividend waivers do not adversely affect depositors and their members’ interest in a mutual holding company. As long as dividends paid to minority shareholders do not exceed net earnings of the mid-tier subsidiary company on an ongoing basis so that the MHC’s aggregate dollar ownership interest in the mid-tier subsidiary company and related subsidiaries does not decrease below such amount that existed at the time of the initial minority stock offering, there should be no requirement on the part of the MHC to seek to increase the equity amount of the MHC itself.

We do not question the authority of the Federal Reserve Board to specify in Regulation MM the substance of the resolutions to be adopted by Grandfathered MHC’s board of directors in waiving dividends. We believe, however, as indicated above, that additional substantive requirements and restrictions on dividend waivers that would have the effect of making waivers impossible, excessively burdensome or unnecessarily costly would be contrary to Congress’s intent in including the grandfathering provisions in Section 10(o) of the HOLA. As such, we strongly recommend that the requirement for an annual vote of members of the MHC to approve the waiver of dividends be removed from Regulation MM as a pre-condition of the MHC’s dividend waiver notice to be filed with the Federal Reserve Board.

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We respectfully submit this comment letter for your consideration in evaluating changes to Regulation MM, and we appreciate having the opportunity to offer our input on this important matter. Should you have any questions, please feel free to contact me at 973-244-4500.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Craig L. Montanaro', with a large, sweeping flourish above the name.

Craig L. Montanaro  
President and Chief Executive Officer