SANDLER
O'NEILL
+ PARTNERS

November 1, 2011

Board of Governors of the Federal Reserve System
c/o Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

BY EMAIL: regs.comments@federalreserve.gov

Re: Docket No. R-1429

Members of the Board:

On behalf of Sandler O'Neill + Partners, L.P., I am commenting on the Board's *Interim Final Rule on Savings and Loan Holding Companies* (SLHCs), effective September 13, 2011, on which the Board requested public comments by November 1, 2011.

Sandler O'Neill is a full-service investment-banking firm focused on the financial services sector.[1] Our clients include a wide variety of financial firms, among them almost 1,000 banks and thrifts and their holding companies. Sandler O'Neill frequently comments on supervisory and other issues important to its clients.

Overview

The interim final rule consists of three parts:

1. Part 238, new Regulation LL, generally governing SLHCs,
2. Part 239, new Regulation MM, governing SLHCs in mutual form (MHCs), and
3. Technical amendments in connection with the transfer of supervisory authority for SLHCs to the Board from the Office of Thrift Supervision (OTS).

This letter comments on two operating restrictions under Part 239 governing MHCs: waiver of dividends, and in particular those MHCs that have previously waived dividends in accordance with the regulations of the OTS in effect prior to

[1] For further information on Sandler O'Neill + Partners, L.P., see http://www.sandleroneill.com/; author contact information: jlongino@sandleroneill.com or 212-466-7936.

the transfer date (Grandfathered MHCs), and repurchase of conversion shares by SLHCs.

Section 239.8(d)(2) sets forth the requirements of an MHC's board resolution filed in support of a notice of intent to waive dividends, including (i) a "description of the conflict of interest that exists because of a mutual holding company director's ownership of stock in the subsidiary declaring dividends" and (ii) an "affirmation that a majority of the mutual members of the mutual holding company eligible to vote have, within the 12 months prior to the declaration date of the dividend by the subsidiary of the mutual holding company, approved a waiver of the dividends by the mutual holding company."

Sections 239.8(c) and 239.63(c) & (d) generally restrict MHC repurchases of conversion shares in the first year after conversion to 5 percent of outstanding shares, and only after the filing of a notice demonstrating "extraordinary circumstances and a compelling and valid business purpose," which the Board has up to 90 days to review.[2]

Dividend Waivers and Share Repurchases in Context

Both the waiver of dividends by an MHC and repurchase of conversion shares by a SLHC are aspects of capital management. As such, we believe they should be left as much as possible to the business judgment of the respective boards of directors of the MHC or SLHC, consistent with (i) the fiduciary duties of the board to shareholders or members, and (ii) the Federal Reserve Board's supervisory responsibilities for promoting safety and soundness. We further believe that the Board's comprehensive supervisory powers over the operations of MHCs and SLHCs permit the Board to strike exactly this balance, and that the Board should amend its interim final rule to better achieve it, as discussed below.

Dividend Waivers

Section 239.8(d) of the Board's regulation implements Section 625 of the Dodd-Frank Act. The statute requires the filing of a notice of intent to waive receipt of a dividend, supported by a resolution of the MHC's board of directors 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." Under

[2] An MHC may not project returns of capital or special dividends in its business plan, and a newly converted MHC may not plan on stock repurchases in the first year of its business plan. Section 239.53(b)(2). The OCC has adopted a companion rule that applies the same restrictions to share repurchases by fully converted SLHCs. *See* 12 CFR 192.510 & 192.515.

the statute, the Board may object to such a notice by Grandfathered MHCs only if the waiver would be "detrimental to the safe and sound operation of the savings association." If the savings association intends to declare a dividend to its SLHC, the savings association must file a companion notice of intent to declare the dividend pursuant to Section 238.103 of the Board's regulations.

Taken as a whole, Section 625 of the Dodd-Frank Act clearly evidences Congressional intent to preserve the *status quo ante* for Grandfathered MHCs, and for good reasons. Enhanced dividends to minority shareholders that dividend waivers make possible are a means of attracting investment in MHCs, since by their nature minority issuances generally are more illiquid and lack any immediate prospect of price appreciation as a result of a change of control. The inchoate ownership interests of members of an MHC (which are not equivalent to the actual ownership interests of minority shareholders, who have invested permanent capital in the SLHC) are protected by the liquidation account, as well as by the general direction of Section 625 that an MHC's board of directors conclude that any proposed dividend waiver is consistent with the fiduciary duties of the board of directors to the MHC's members. Moreover, members wishing to receive enhanced dividends are given the first priority to do so by investing in those shares when offered in the conversion offering. In short, Section 625 clearly seeks to protect Grandfathered MHCs whose business strategies rely upon dividend waivers.

We regard as problematic the requirement of Section 239.8(d)(2)(i) of the Board's implementing regulation that the MHC's board resolution filed in support of a notice of intent to waive dividends include a "description of the conflict of interest that exists because of a mutual holding company director's ownership of stock in the subsidiary declaring dividends and any actions the mutual holding company and board of directors have taken to eliminate the conflict of interest, such as waiver by the directors of their right to receive dividends."

If director ownership of shares of banking companies declaring and paying dividends were deemed a conflict of interest – either *per se* or by reason of amount – unless directors waived their right to receive dividends, there would be very little director stock ownership of banking companies on whose boards they serve, a circumstance not calculated to promote safety and soundness. Moreover, the description of the conflict of interest required in the board of directors resolution is arguably an admission against interest that could expose directors to liability for breach of fiduciary duty in civil litigation.

We similarly regard as overreaching the requirement of Section 239.8(d)(2)(iv) of the Board's implementing regulation that a Grandfathered MHC obtain an annual approval of waiver of dividends from a majority of the MHC's members. Such a requirement is not included in the provisions of Section 625 of the Dodd-Frank Act and is arguably inconsistent with the charter and by-laws of Grandfathered MHCs, which do not grant voting rights to members with respect to dividend waivers. Further, the costs of obtaining such approval, which could easily exceed $100,000 to $200,000 annually, would be grossly disproportionate to any benefit obtained.

For these reasons, we urge the Board to delete Sections 239.8(d)(2)(i) & (iv) from its interim final rule and to delete the five references to conflicts of interest elsewhere in Section 239.8(d). Doing so would give better effect to clear Congressional intent without unintended adverse consequences for MHCs that waive dividends. Such revisions would in no manner compromise the Board's ability to review and act on notices of dividend waivers in the interest of safety and soundness.

Share Repurchases

The Board's restriction on an MHC's repurchase of conversion shares in the first year after conversion carries over the substance of the predecessor OTS notice requirement but expressly provides for a period for supervisory review and action of up to 90 days.

The limitation on share repurchases in the first year after conversion to 5 percent of outstanding shares after the filing of a successful notice demonstrating "extraordinary circumstances and a compelling and valid business purpose" probably had its origins in the early financial abuse of subsidiary thrifts by their holding companies, as well as the need for thrifts to retain recently raised capital in times of economic stress such as the U.S. thrift crisis in the 1980s.[3] As well, there is an apparent contradiction between raising new capital and returning some of it within a short time frame.

As noted above, the Board's comprehensive supervisory powers over the operations of MHCs (as well as SLHCs), including the Dodd-Frank Act's

[3] *See generally* Thomas B. Marvell, *The Federal Home Loan Bank Board* (New York: Frederick A. Praeger, 1969), pp.199-216; Lawrence J. White, *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation* (New York: Oxford University Press, 1991), pp. 105-107.

application of the Board's source of strength doctrine to SLHCs,[4] substantially address concerns over financial abuse of subsidiary thrifts by their holding companies. In addition, the apparent contradiction between raising capital and returning some of it within a short time frame is just that – *apparent* – for there are perfectly legitimate business reasons for doing so, including price support of recently issued shares in volatile markets and return of excess capital raised to make an offering possible or economical.

The Board's reservation of as much as 90 days for its review of a notice that must demonstrate "extraordinary circumstances and a compelling and valid business purpose" for the repurchase of conversion shares strikes us as inconsistent. Although we understand the Board's desire to reserve sufficient time for considered supervisory review, surely as much as 90 days would defeat the purpose of a notice filed in the context of "extraordinary circumstances" and "compelling" need. For this reason, we suggest that the Board promptly revise its interim final rule to commit itself to review and act on a notice of share repurchase no more than 30 days after it is deemed to be complete.

We appreciate that the Board and the OCC have adopted rules implementing the transfer of various supervisory authorities from the OTS under very tight schedules. We therefore suggest that as time and experience permit, the Board consider revising Sections 239.8(c) and 239.63(c) & (d) to delete the 5 percent limitation on repurchased shares in the first year after conversion and require that only a "valid business purpose" for the share repurchase be demonstrated. We further suggest that the Board coordinate with the OCC in considering and implementing any such revisions.

Very truly yours,

Joseph Longino
Principal

[4] Section 616 of the Dodd-Frank Act makes all holding companies sources of financial strength for their insured depository subsidiaries.

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