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VIA MESSENGER

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

Re: Savings and Loan Holding Companies: Regulation LL; Docket No. R-1429; RIN No. 7100 AD-80

Dear Ms. Johnson:

We appreciate the opportunity to comment on the interim final rule published by the Board of Governors of the Federal Reserve System (the "Board") regarding the regulation of savings and loan holding companies ("SLHCs"). This law firm represents numerous savings associations and SLHCs. This letter specifically addresses the control regulations and provisions regarding the determination of SLHC status as they relate to tax-qualified stock benefit plans[1/] established by SLHCs or savings associations and the trustees of such plans. While we understand that the formal comment period has ended, we have recently discussed the issues addressed in this letter with Board staff who indicated that a letter regarding the Regulation LL proposal could still be filed with the Board.

Many of our clients organized SLHCs as part of a mutual-to-stock conversion of a mutual savings association. In connection with that transaction, the SLHC formed an employee stock ownership plan ("ESOP") for the benefit of the organization's employees. It was the policy of the Office of Thrift Supervision ("OTS") to encourage the establishment of ESOPs in the stock conversion process by providing priority subscription rights for such plans and permitting tax-qualified plans to purchase up to 10% of the common stock issued in the conversion offering. As a result, the OTS created various exemptions and exceptions for tax-qualified plans and their trustees in the OTS control regulations. We note that the Board carried over to Regulation LL

[1/] While many of our comments relate to tax-qualified stock benefit plans in general, this comment letter focuses on employee stock ownership plans, since most mutual savings associations that convert to the stock form of organization establish such a plan as part of that process.

the major control exemption provided for in the OTS regulations permitting acquisitions of up to twenty-five percent (25%) of the outstanding shares as discussed below. However, because the Board did not carry over to Regulation LL certain other provisions of the OTS control regulations, the current version of Regulation LL will require many ESOPs and their trustees to make control filings under Regulation LL for stock holdings that were previously exempt under OTS interpretations. As discussed below, this problem is further exacerbated by the Board's stock attribution rules which are broader than were the OTS attribution rules.

Recommended Revisions to Regulation LL

For the reasons discussed below, we respectfully request that the final form of Regulation LL include the following provisions:

1. The Board should expand the exemption for a control filing by an ESOP and its trustees that hold less than 25% of the voting stock of an SLHC to apply as well to the Change in Bank Control Act (12 U.S.C. § 1817(j)) (the "Control Act").

2. If the Board does not add an exemption from the Control Act for ESOPs, it should add an exception that excludes an ESOP trustee from being a party to ESOP Control Act filings.

3. If the staff believes that the exemption previously provided by the OTS should not be applicable to all future ESOPs, then we urge the staff to at least grandfather all existing ESOPs and their current holdings, including existing ESOPs whose current holdings may presently be less than 10% of the outstanding voting stock but whose holdings may in the future exceed 10% due to actions taken by the SLHC, including, but not limited to, stock repurchases.

We believe it is appropriate to revise Regulation LL to include the exemption previously provided by the OTS regulations for ESOPs and their trustees, particularly in light of the ongoing federal regulatory policy to encourage the adoption of ESOPs in the stock conversion process and the extensive regulation of ESOPs by both the Internal Revenue Service (the "IRS") and the U.S. Department of Labor (the "DOL"). The control filings which will be required in the absence of such exemptions could be more time consuming and expensive than currently contemplated by the staff, especially since many ESOPs have individuals serving as trustees who are members of the organization's senior management. Those individuals and members of their immediate families and affiliated entities would be required to join the required control filings. Even where an individual trustee holds no SLHC shares directly or through attribution (other than from the ESOP), the requirement for an individual trustee to provide detailed biographical and financial information is likely to be a major disincentive for such an individual to continue to serve as a trustee for a tax-qualified plan whose holdings were previously exempt from such filings. Moreover, such informational requirements could also be a major disincentive for third party corporate trustees continuing to serve as a trustee. Finally, the compliance cost related to the maintenance of an ESOP and the cost of retaining the services of a corporate trustee (when utilized) are additional burdens to the SLHCs and their savings association subsidiaries and ESOPs, especially for small community banking organizations.

To assist the Board in its analysis of the issues raised by this comment letter, we have provided below information related to the prior OTS rules as well as a discussion of the extensive regulation applicable to an ESOP and the significant limitations on the voting powers of its trustees.

The ESOP Exemption Under Prior OTS Rules

Under former 12 C.F.R. Part 574 of the OTS regulations (the "OTS Control Regulations"), the OTS utilized a unified approach to implementing the provisions of the Control Act and the Savings and Loan Holding Company Act (12 U.S.C. § 1467(a)) (the "SLHCA") relating to acquisitions and changes in control of savings associations. Among the provisions included in the OTS Control Regulations was 12 C.F.R. § 574.3(c)(1)(vii), which exempted from control filings under the Control Act and the SLHCA acquisitions of up to twenty-five percent (25%) of a class of stock by a tax-qualified employee stock benefit plan. Section 238.12(a)(6) of Regulation LL carries over this exemption for purposes of SLHCA filings, but does not provide a similar provision for Control Act filings.

The OTS Control Regulations also provided for an exception for a trustee of a tax-qualified employee stock benefit plan from the presumptions of concerted action generally applicable to a trust and each of its trustees. (See former 12 C.F.R. § 574.4(d)(6) and 12 C.F.R. § 574.2(c)(3)). There are no similar provisions in Regulation LL. As a result, Regulation LL's presumption that a trust and its trustee are acting in concert is applicable to a tax-qualified employee stock benefit plan and its trustees.

Board Stock Attribution Rules

The impact of the absence in Regulation LL of the exemption and exceptions noted above is compounded by the difference between the stock attribution rules of the Board and those of the OTS. The OTS attribution rules only included stock options, warrants and other convertible stock where the holder had the preponderant economic risk in the underlying voting stock. This rule generally excluded all stock options from inclusion as voting stock, since the options themselves were generally issued at no cost to the recipient. Since the Board's stock attribution rules require all stock options, warrants and other convertible stock to be included in stock ownership totals as if they all had been fully converted, the ownership totals will, in most cases in which stock option plans exist and the trustee holds options in the SLHC stock, be considerably higher under Regulation LL.

Extensive Regulation of ESOPs by the IRS and the DOL

As tax-qualified pension plans, ESOPs are extensively regulated by both the IRS and the DOL. One of the primary principles of this extensive regulatory scheme is that the ESOP trustees and other plan fiduciaries must at all times act in the best interests of the plan participants, rather than in the interests of the plan sponsor. This extensive regulatory scheme and the attendant fiduciary duties imposed on the ESOP trustees and other plan fiduciaries distinguish ESOPs from non-tax-qualified plans which may hold common stock of the SLHC.

The IRS and the DOL prohibit many types of transactions between an ESOP on the one hand and its trustees, other fiduciaries and service providers on the other hand. Any violation of these regulations triggers requirements to disclose the prohibited transaction and the imposition of substantial excise taxes.

ESOPs are broad-based pension plans in which all employees of the plan sponsor who meet certain minimum age and service requirements automatically participate in the plan. Typically all employees who are at least 21 years of age and who have at least six or 12 months of service participate in the ESOP, and these employees receive allocations to their ESOP accounts on a proportionate basis with the other participants in the ESOP.

In non-leveraged ESOPs, all of the shares held by an ESOP are allocated to the accounts of the ESOP participants. In leveraged ESOPs where the purchase of common stock by the ESOP was financed with a loan (which generally occurs in a mutual-to-stock conversion), the shares held by the ESOP are allocated to the ESOP participants as the loan is repaid, consistent with the regulations of the IRS and the DOL.

Voting of Shares Held by an ESOP

Both the IRS and the DOL require that ESOP participants be given the right to direct the voting of the shares of common stock allocated to their ESOP accounts. See for example Section 409(e) of the Internal Revenue Code of 1986, as amended (the "Code") and Section 403(a)(1) of the Employee Retirement Income Security Act ("ERISA") (trustee must follow the directions of a named fiduciary (*i.e.*, a plan participant) if the named fiduciary's directions are proper, are made in accordance with the terms of the plan, and are not contrary to ERISA). See also letter from DOL to Ian D. Lanoff dated September 28, 1995.

Applicable regulations, case law and DOL guidance require that ESOP participants receive necessary and accurate information in order to allow them to be fully informed as they consider how to vote. For all practicable purposes, the ESOP participants are deemed to be the beneficial owners of the shares of common stock allocated to their ESOP accounts.

In leveraged ESOPs where a portion of the shares of common stock held by the ESOP have not yet been allocated to ESOP participants, the unallocated shares are voted by the ESOP trustees based on the voting directions received by the trustees from ESOP participants with respect to their allocated shares. There are two methods by which the trustees vote the unallocated shares. The first method is the mirror voting method, where the unallocated shares are voted for and against the proposal in the same proportion that allocated shares were voted for and against the proposal. The second method is the majority vote method, where all of the unallocated shares are voted in the same manner as a majority of the allocated shares were voted. In both cases, the trustees of the ESOP are voting the unallocated shares based on the voting instructions received from ESOP participants with respect to the shares allocated to the accounts of ESOP participants, subject to the limitation noted below.

In certain very limited circumstances, the fiduciary duties of the ESOP trustees under Section 404(a) of ERISA may require the trustees to vote the unallocated shares in a manner different than the mirror voting method (or majority vote method) would otherwise dictate. These circumstances arise only when the ESOP trustees determine that the participants' voting directions for the allocated shares were either imprudent or would lead to an imprudent result. These circumstances are exceedingly rare.

Conclusion

The provisions in Regulation LL applicable to control determinations for ESOPs differ significantly from the predecessor provisions contained in the OTS Control Regulations. Their application as proposed, without modification or, at the very least, grandfathering of current holdings would add a considerable regulatory burden to ESOPs and ESOP trustees, especially those with investments in smaller SLHCs. Moreover, the implementation of the provisions will increase the compliance cost for maintaining ESOPs and in certain cases add the cost of retention of corporate trustees, which costs will be especially burdensome to small community banking organizations. For the reasons discussed above, the Board should amend Regulation LL to include the exemptions and exceptions previously contained in the OTS Control Regulations. If the Board determines not to adopt those revisions, it should provide clear grandfathering guidelines for ESOPs and ESOP trustees that currently exceed Regulation LL control thresholds or that may exceed those thresholds in the future due to actions taken by the SLHC in which they hold an investment.

Thank you for your consideration of this comment letter. We would be pleased to discuss these issues with you at your convenience.

Very truly yours,

John P. Soukenik

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