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Proposal and Comment Information

Title: Regulatory Modernization and Relief for Mutual Holding Companies (Reg Q and MM), R-1895

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Subject

Comments on Docket No. R-1895 and RIN 7100-AH26

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Via E-Mail (publiccomments@frb.gov)

Mr. Benjamin W. McDonough
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

**Re: Regulatory Modernization and Relief for Mutual Holding Companies
(Regulations MM and Q)
Docket No. R-1895 and RIN 7100-AH-26**

Dear Mr. McDonough:

Luse Gorman, PC appreciates the opportunity to comment on the Notice of Proposed Rulemaking entitled “*Regulatory Modernization and Relief for Mutual Holding Companies*” (the “Proposal”) issued by the Board of Governors of the Federal Reserve System (the “Board”). Founded in 1993, we are a specialty law firm dedicated to representing financial institutions, with a particular emphasis on community banks. Since our founding, we have grown into one of the largest community financial institution law firm in the nation. Much of our practice focuses on transactional matters. We advise financial institutions on a broad range of capital raising transactions, including mutual-to-stock conversions, mutual holding company (“MHC”) reorganizations, common stock and preferred stock offerings, subordinated debt offerings, among other matters. Since 2000 we have been the leading law firm in the United States for MHC reorganization transactions and for mutual-to-stock conversion transactions by MHCs and mutual institutions, based on number of transactions.¹

I. General

We generally support the Proposal, which would update and modernize Regulation MM (12 CFR Part 239) as well as amend Regulation Q (12 CFR Part 217) to include mutual capital certificates and special deposits issued by mutual institutions. As noted in the Proposal Regulation MM has not been amended since its adoption in 2011, and many of the proposed updates and revisions outlined in the Proposal would benefit MHCs and mutual institutions.

¹ Source: S&P Global Market Intelligence.

In support of the Board's efforts, we respectfully submit comments with respect to the following aspects of the Proposal:

- mutual capital instruments;
- dividend waivers;
- stock benefit plans;
- membership voting; and
- other technical aspects.

II. Mutual Capital Instruments

The Proposal addresses an urgent need to create new avenues for mutually owned institutions to raise outside capital. The proposed amendments to Section 217.20 create a pathway for mutual capital instruments that are permanent, deeply subordinated and without any distribution or redemption requirements and, therefore, fully available to absorb losses.

The availability of mutual capital instruments supports the interests of both mutual institutions and their prudential regulators. In order to encourage the use of these instruments, the Board should consider the following:

Recommendation 1: Profit Participation. The preamble to the Proposal states that special deposits “could entitle holders to modest earnings based on bank profits.” The ability to tie discretionary payments to bank profitability could significantly enhance the marketability of mutual capital instruments. For instance, a specified percentage of bank profits could be tied to a class of mutual capital instruments. A profit-participation feature would give mutual capital instruments economic characteristics closer to common equity, broadening the potential investor base. The above quoted statement from the preamble is unclear in two respects. First, the statement could be read to limit profit participation to special deposits as opposed to other types of mutual capital instruments. Second, the definition of “modest” earnings is unclear and not tied to any language in the proposed regulation.

Profit participation is consistent with Section 217.20 and should be permitted for all types of mutual capital instruments. We respectfully request that the preamble to the final rule expressly confirm that discretionary, profit-linked distributions are permissible for all categories of mutual capital instruments under Section 217.20, and that the Board decline to impose a prescriptive definition of “modest” so as to preserve appropriate issuer flexibility.

Recommendation 2: Form of Instruments. The preamble to the Proposal rightly notes that there may be additional forms of capital instruments which comply with Section 217.20 beyond mutual capital certificates. In this regard, we believe that Federal MHCs could use their inherent authority to enter into contracts to issue instruments complying with Section 217.20 without the need for a charter amendment. This would eliminate the charter amendment process,

which involves member approval as well as a 30-day notice to the Board. Clarifying a Federal MHC's ability to implement such an instrument would expedite the issuance process and facilitate capital raising by eliminating the time and expense associated with the charter amendment process. We respectfully urge the Board to clarify in the preamble to the final rule that a Federal MHC may issue instruments complying with Section 217.20 under its existing authority to enter into contracts, without the need for a charter amendment.

Recommendation 3: Preferred Stock. Non-cumulative, non-voting, non-convertible preferred stock with terms complying with Section 217.20 is, from an investment standpoint, the functional equivalent of mutual capital certificates. In addition, because preferred stock is a more familiar form of investment than mutual capital certificates, there may be a significant marketing advantage to an MHC in offering preferred stock in a subsidiary holding company in lieu of a mutual capital instrument. Like mutual capital certificates, non-cumulative preferred stock satisfies the key Section 217.20 criteria – it is permanent, deeply subordinated, and carries no mandatory distribution or redemption requirements.

Section 239.24 of Regulation MM can be read to require that, in order to offer preferred stock, the issuing mutual organization must structure the offering like a mutual to stock conversion and offer the preferred stock to all members in an offering registered with the U.S. Securities and Exchange Commission (the “SEC”). This would be impractical – given the cost of SEC registration for what would likely be a modest offering and the difficulty of conducting a subscription offering to a potentially large and dispersed membership – and would essentially foreclose any opportunity to issue preferred stock. Based on the above, we respectfully recommend that the definition of “stock” in Section 239.2 be amended to exclude noncumulative, nonvoting, non-convertible, preferred stock. We note that such an amendment would not undermine the member protections underlying the mutual-to-stock conversion framework in Section 239.24, because non-cumulative, non-voting, non-convertible preferred stock does not confer governance rights or dilute mutual members' economic interests.

Recommendation 4: Community Reinvestment Act (“CRA”) Qualified Investment Treatment for Mutual Capital Instruments. We respectfully recommend that the Board consider updating its regulations to establish a new mutual-institution issuer category under which a financial institution's lawful investment in a mutual capital certificate or other qualifying mutual capital instrument issued by a mutual banking organization would receive CRA qualified investment consideration. Congress expressly and broadly authorized and directed the federal banking agencies to implement regulations carrying out the purposes of the CRA, which is to encourage regulated institutions to help meet the credit needs of the local communities in which they are chartered, consistent with safe and sound operations.²

The Board has recognized in this Proposal that mutual banking organizations focus uniquely on their members and local communities, can prioritize long-term stability over near-term profits, and face capital-raising constraints that may limit their ability to grow and increase the products and services they provide to their communities. A formal mutual-institution issuer CRA category for mutual capital instruments would align the CRA framework with the Board's

² 12 U.S.C. § 2901.

capital-rule modernization by encouraging outside investment in instruments that strengthen mutual institutions without requiring them to dilute or surrender mutuality.

Recommendation 5: Clarification that Part 239 Subscription Rights do Not Apply to Mutual Capital Instrument Offerings. As noted above, there are a series of specific offering requirements (including members' subscription rights, SEC registration, etc.) that apply to stock offerings by mutual organizations. The term "stock" is currently defined in Section 239.2 as "common or preferred stock, or any other type of equity security." In addition to our recommendation to exclude noncumulative, nonvoting, non-convertible, preferred stock from the definition of "stock," we further recommend that the Board consider clarifying that mutual capital instruments are not considered stock for the purposes of Part 239.

III. Dividend Waivers

We express our general support for the Board's proposed amendments to the dividend waiver provisions of Regulation MM. The proposed rule represents a meaningful and long-overdue modernization of the regulatory framework governing MHC dividend waivers. Since the Board assumed regulatory authority over savings and loan holding companies ("SLHCs") following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), the burdensome dividend waiver conditions of the 2011 Interim Final Rule have impaired the viability of the MHC structure and discouraged capital formation through MHC minority stock offerings. The proposed rule's elimination of certain unnecessary conditions, particularly the annual member vote requirement for legacy waiver MHCs and the disinterested-director and insider-waiver requirements for non-legacy waiver MHCs, will promote the continued utility of the MHC structure as a vehicle for incremental capital raising by mutual institutions.

The experience under the Office of Thrift Supervision's (the "OTS") post-2000 liberalized framework provides positive evidence of the attractiveness and viability of the MHC structure when a workable dividend waiver policy was in place. Following the OTS's July 2000 liberalizing amendments³, the OTS approved 49 MHC stock offerings through 2008. By contrast, since the adoption of the 2011 Interim Final Rule and its burdensome dividend waiver conditions, only 18 MHC minority stock offerings have been completed as of the date hereof. This contrast demonstrates how an effective dividend waiver policy can facilitate increased access to capital, while restrictive conditions can materially impede the use of the MHC structure for minority stock offerings.

We respond next to the Board's specific questions on dividend waivers and then raise two additional issues for the Board's consideration.

³ 65 Fed. Reg. 43,088 (July 12, 2000).

A. Question 1: Board Fiduciary Determination

Question 1 asks whether the MHC board's determination that dividend waivers are consistent with fiduciary duties to members is sufficient to mitigate potential conflict-of-interest concerns, and whether the Board should consider alternative requirements.

We affirmatively believe a board-level fiduciary determination, as contemplated by both Section 10(o)(11)(C) of the Home Owners' Loan Act, as amended (the "HOLA")⁴, and proposed Section 239.8(d), is fully sufficient to address any potential conflict of interest concerns associated with MHC dividend waivers. We urge the Board not to impose additional alternative requirements.

The statutory framework establishes a clear standard. HOLA Section 10(o)(11)(B) provides that an MHC may waive the right to receive any dividend if no insider or associate holds shares in the relevant class, or if the MHC provides 30 days' prior written notice to the Board and the Board does not object. HOLA Section 10(o)(11)(C) requires that the notice include a board resolution "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." For legacy waiver MHCs, HOLA Section 10(o)(11)(D)⁵ provides that the Board "may not object" to a waiver so long as: (i) the waiver would not be detrimental to safe and sound operation of the savings association and (ii) the board expressly determines the waiver is consistent with its fiduciary duties to the mutual members. This statutory structure makes clear that Congress regarded the board's fiduciary determination coupled with the Board's non-objection authority as the appropriate mechanism for conflict mitigation.

MHC boards of directors are fully capable of identifying and managing potential conflicts of interest associated with dividend waivers, as they routinely do in other contexts that present comparable or more significant conflict concerns. MHC and their subsidiary boards (usually comprised of the same board members) regularly evaluate and approve stock benefit plans (including stock option plans and restricted stock awards), executive compensation arrangements, related-party transactions, and insider lending which all involve direct financial benefits to board members and management. Federal and state banking regulators have long recognized that directors can faithfully discharge their fiduciary duties notwithstanding a personal financial interest, provided that adequate disclosure, deliberation, and appropriate documentation occur. There is no principled basis for treating a dividend waiver decision differently or for presuming that an MHC board is uniquely incapable of managing this particular conflict.

Moreover, the premise that an "inherent" conflict of interest exists whenever an MHC board waives dividends overstates the nature and magnitude of the interest at issue. A dividend waiver enhances the capital of the subsidiary savings bank by retaining earnings (including the tax that would otherwise be payable by the MHC on dividends received), thereby strengthening the subsidiary's financial condition and the organization as a whole. The waiver benefits all

⁴ 12 U.S.C. § 1467a(o)(11)(C).

⁵ Section 10(o)(11)(D) codifies Dodd-Frank Wall Street Reform and Consumer Protection Act § 625(a).

stockholders proportionally through increased book value and stock price. Any incremental benefit to directors who hold minority shares is shared equally with all other minority stockholders.

The Board should also consider the nature of the mutual members' interest. As the United States Supreme Court recognized in *Paulsen v. Commissioner*⁶, the equity characteristics of deposit accounts are “not as substantial as they appear on the surface” and the “incremental value attributable to the equity features was practically zero.”⁷ Members do not have the right to receive any portion of dividends paid to an MHC, and dividends received by the MHC do not result in any tangible benefit to members either at the time of payment or upon conversion of the MHC to stock form. We believe the MHC board's fiduciary determination and the Board's non-objection review are more than adequate to protect members given the extremely limited nature of member economic interests.

For these reasons, we respectfully submit that no alternative requirements beyond the board fiduciary determination and notice to the Board are necessary or appropriate. The proposed framework under Section 239.8(d), together with the disclosure requirements of proposed Section 239.8(d)(2)(iv) regarding prior member disclosure of dividend waivers for legacy waiver MHCs or proposed Section 239.8(d)(4)(iii) regarding disclosures in connection with a member vote for non-legacy waiver MHCs, adequately mitigates any potential conflict of interest concerns.

B. Question 2: Legacy and Non-Legacy Waiver MHC Distinction

Question 2 asks whether the Board should continue to distinguish between legacy waiver MHCs and non-legacy waiver MHCs, whether the proposal strikes the right balance, and, if not, what alternative balancing should be considered.

We support the Board's decision to maintain a distinction between legacy and non-legacy waiver MHCs due to the creation of the two categories as part of the statutory framework of HOLA as amended by the Dodd-Frank Act while substantially reducing the regulatory burden on both categories. We believe the current proposal provides an appropriate balance between the two categories.

The proposed rule deliberately calibrates different procedural requirements for each category. Under the proposed rule, legacy waiver MHCs would need the board's fiduciary determination under HOLA Section 10(o)(11)(C)-(D), the 30-day prior notice, and the Board's non-objection. In addition, proposed Section 239.8(d)(2)(iv) would require legacy waiver MHCs to make appropriate disclosures regarding dividend waivers to each person who becomes a member at the time of opening a deposit account or entering into a loan relationship. This prospective disclosure mechanism ensures new members are aware of the MHC's dividend waiver practice and the associated conflict-of-interest considerations, without imposing the

⁶ *Paulsen v. Commissioner*, 469 U.S. 131, 138, 140 (1985).

⁷ See also *Society for Savings v. Bowers*, 349 U.S. 143, 150 (1955) (characterizing the depositor's contingent liquidation right as one whose “theoretical value reduces almost to the vanishing point”).

burden or expense of a periodic member vote. For non-legacy waiver MHCs, the proposed rule adds the decennial member vote under proposed Section 239.8(d)(4)(iii), with proxy disclosure of the proposed waiver, directors' stock ownership, and conflict-of-interest considerations. This distinction is a deliberate regulatory choice: the Board has concluded that legacy waiver MHCs' established track record of dividend waivers (in some cases more than 10 years) provides sufficient evidence that the practice does not harm members, and the new-member disclosure requirement provides an ongoing awareness mechanism without the cost of periodic solicitations. Non-legacy waiver MHCs, which lack that track record, warrant the additional layer of periodic member oversight that the decennial vote provides.

C. Question 3: Decennial Member Approval

Question 3 asks whether the requirement that non-legacy waiver MHCs obtain the approval of members on a decennial basis is appropriate, and whether non-legacy waiver MHCs should be required to obtain member approval on a more or less frequent basis, such as every three years or every five years.

The 10-year interval is both equitable and practical. Under current Regulation MM, non-legacy waiver MHCs face a set of conditions for dividend waivers, including the disinterested-director approval requirement and the condition that insiders waive their own dividends, that are as a practical matter, prohibitive. The proposed 10-year member vote replaces these unworkable conditions with a mechanism that provides meaningful member participation without the excessive cost and administrative burden of annual solicitations. A 10-year cycle allows MHCs to plan and budget for member votes at reasonable intervals, provides continuity and certainty for capital planning, and avoids the uncertainty that more frequent votes impose on the MHC subsidiary's ability to pay dividends to minority stockholders. We recognize that the Board has determined that some level of periodic member affirmation is warranted for non-legacy waiver MHCs. Annual member votes on dividend waivers, as currently required for legacy waiver MHCs under the 2011 Interim Final Rule or votes on a more frequent basis, are unnecessarily burdensome imposing significant costs on MHCs such as proxy solicitation expenses, printing and mailing costs, and the fees of independent proxy solicitation firms that are disproportionate to the interests at stake. The 10-year cycle strikes a reasonable balance: it ensures that members of MHCs organized after December 1, 2009 (or that did not waive dividends before that date) have an opportunity to consider and approve the practice, while recognizing that the underlying economics and conflict-of-interest analysis do not change materially over time.

Accordingly, we support the proposed 10-year member vote requirement for non-legacy waiver MHCs as striking the appropriate balance between equitable considerations and operational practicality.

D. Question 4: Additional Procedural Changes

Question 4 asks whether the Board should consider any additional changes to the procedural requirements associated with dividend waivers to reduce burden, and what the advantages and disadvantages of such changes would be.

The Board should permit MHCs to include enhanced disclosures regarding the intent to waive dividends and the associated conflict-of-interest analysis in the initial reorganization proxy statement in connection with a minority stock offering. If the reorganization proxy statement contains disclosure that is substantially equivalent to the disclosure required under proposed Section 239.8(d)(4)(iii), including a description of the proposed waiver, the reasons for the waiver, the directors' stock ownership in the subsidiary, and any conflict-of-interest actions taken by the board, then the member vote on the reorganization itself should be deemed to satisfy the initial decennial vote requirement. This approach would avoid the unnecessary cost and delay of a separate solicitation when members have already been fully informed and have approved the reorganization with knowledge that dividend waivers will occur. Nothing in HOLA Section 10(o)(11) requires that the member vote on dividend waivers be conducted as a separate, standalone solicitation.

E. Exchange Ratio Treatment for Non-Legacy Waiver MHCs

In order to remove a potential barrier to dividend waivers, we respectfully urge the Board to exercise its discretion under HOLA Section 10(o)(11)(E)(i)⁸ to exclude waived dividends from the exchange ratio calculation in second-step conversions for non-legacy waiver MHCs, consistent with the treatment currently afforded to legacy waiver MHCs under HOLA Section 10(o)(11)(E)(ii).

1. Background

When an MHC undertakes a "second-step," the shares of subsidiary common stock held by the MHC are canceled and new shares of the newly formed, fully converted holding company are offered for sale to depositors and the public at fair value. The exchange ratio is the mechanism by which existing minority stockholders receive shares of the newly formed, fully converted holding company in exchange for their existing shares. The exchange ratio is calculated to preserve the minority stockholders' aggregate percentage ownership interest in the converted entity as it existed immediately prior to the conversion – that is, minority stockholders receive a number of new shares sufficient to maintain their pre-conversion proportionate ownership. HOLA Section 10(o)(11)(E)⁹ directly governs this calculation by specifying whether waived dividends will be taken into account in determining the exchange ratio. Under HOLA Section 10(o)(11)(E)(i), the appropriate federal banking agency "shall consider" waived dividends in determining the exchange ratio. If waived dividends are applied in the valuation the MHC's ownership interest would increase by the cumulative amount of waived dividends thereby reducing the number of exchange shares issued to minority stockholders and diluting their percentage ownership. HOLA Section 10(o)(11)(E)(ii) creates a mandatory exception for legacy waiver MHCs: the agency "shall not consider" waived dividends for MHCs that reorganized, issued minority stock, and waived dividends before December 1, 2009. The exchange ratio is thus a critical variable in any second-step conversion and has a direct, material impact on the economic interests of minority stockholders and therefore on the overall usefulness of dividend waivers.

⁸ 12 U.S.C. § 1467a(o)(11)(E)(i).

⁹ 12 U.S.C. § 1467a(o)(11)(E).

2. If dividend waivers are not excluded from the exchange ratio, dividend waiver reform will be illusory for non-legacy waiver MHCs

The proposed rule's reforms to the procedural requirements for dividend waivers by non-legacy waiver MHCs, including the replacement of the current prohibitive conditions with the 10-year member vote, are a significant step forward. However, the practical benefits of these procedural reforms will be limited if the Board does not also address the exchange ratio treatment of waived dividends for non-legacy waiver MHCs. If accumulated waived dividends inflate the MHC's ownership interest in a second-step conversion, minority stockholders will face cumulative dilution that grows with each year of dividend waivers. This economic deterrent will significantly undermine the benefit of the proposed dividend waiver reform: experienced MHC investors will discount the value of MHC minority stock to account for the risk of future dilution, thereby undermining the capital-raising objective that the MHC structure is designed to serve. The experience of the industry since the enactment of the Dodd Frank Act with the limited number of MHC stock offerings confirms that exchange ratio treatment and procedural reform are inseparable components of a workable dividend waiver regime. The prospect that waived dividends will dilute a minority stockholder's ownership percentage in a second-step conversion introduces substantial uncertainty into the investment in MHC minority stock. This uncertainty depresses MHC stock valuations, increases the cost of capital for MHCs, and discourages investors from participating in MHC minority stock offerings. The cumulative dilution effect grows over time, creating perverse pressure on MHCs to convert to full stock form before their business plans and capital needs would otherwise call for such a conversion in order to limit the dilution to existing minority stockholders. This result is antithetical to the original purpose of the MHC structure: to allow mutual institutions to raise capital incrementally and convert to stock form at a pace that suits their business needs.

3. The conditions the proposed rule imposes on non-legacy waiver MHC dividend waivers address every substantive consideration relevant to exchange ratio treatment

HOLA Section 10(o)(11)(E)(i) provides that, in general, the appropriate federal banking agency "shall consider" waived dividends in determining the exchange ratio in a full conversion to stock form. HOLA Section 10(o)(11)(E)(ii) then provides a mandatory exception for legacy waiver MHCs: the agency "shall not consider" waived dividends for MHCs that reorganized, issued minority stock, and waived dividends before December 1, 2009. While HOLA Section 10(o)(11)(E)(i) states a general rule, it does not mandate a particular outcome; rather, it requires the Board to "consider" waived dividends, a term that encompasses the discretion to conclude, on the basis of the relevant facts and policy considerations, that waived dividends should not affect the exchange ratio.

The Board should conclude that dividend waivers that comply with the non-legacy waiver standards proposed in the new Section 239.8(d) should automatically allow the Board to exercise its authority to consider and exclude waived dividends from the exchange ratio. The proposed 10-year member vote for non-legacy waiver MHCs together with the board's

fiduciary determination, the 30-day prior notice to the Board and the Board's non-objection authority will provide a robust system of conflict-of-interest protections.

Proposed Section 239.8(d)(4)(i) requires the non-legacy waiver MHC to demonstrate that the waiver is not detrimental to the safe and sound operation of the savings association, while HOLA Section 10(o)(11)(B) preserves the Board's non-objection authority over all waivers. HOLA Section 10(o)(11)(C) and proposed Section 239.8(d)(4)(iv) require the non-legacy waiver MHC board to expressly determine that the waiver is consistent with the board's fiduciary duties to the mutual members despite any conflict of interest. Proposed Section 239.8(d)(4)(iii) requires direct member approval by a majority of votes cast, supported by proxy disclosure of the proposed waiver, the reasons for the waiver, the directors' stock ownership, and the conflict-of-interest actions taken by the board every 10 years. There is no need for the additional penalty of minority stockholder dilution if an MHC complies with the above summarized procedural safeguards which collectively address every substantive consideration the Board could apply when exercising its discretion to exclude waived dividends from the exchange ratio calculation under HOLA Section 10(o)(11)(E)(i).

For these reasons, we respectfully request that the Board exercise its discretion under HOLA Section 10(o)(11)(E)(i) to exclude waived dividends from the exchange ratio calculation for non-legacy waiver MHCs in second-step conversions.

F. Greater Delaware Valley Opinion and Parity for BHCs

We respectfully request that the Board address the treatment of bank holding companies ("BHCs") organized in mutual form with respect to dividend waivers, and in particular the conflict-of-interest framework established in the Board's opinion in *Greater Delaware Valley Holding, MHC*¹⁰ ("*Greater Delaware Valley*").

1. Background

In *Greater Delaware Valley*, the Board denied an MHC's request to waive receipt of dividends from its subsidiary bank. The Board identified a conflict of interest arising from the fact that the same individuals served as trustees of the MHC, directors of the subsidiary bank, and minority stockholders of the bank. These individuals established the dividend rate, declared the dividend, waived it at the MHC level, and benefited personally as minority stockholders from the retained capital. The Board identified two potential benefits to minority stockholders from such waivers: (1) a value transfer from the MHC to minority stockholders through increased book value; and (2) the ability to receive higher dividends because the MHC's share of the dividend remained in the subsidiary's capital.¹¹

¹⁰ *Greater Delaware Valley Holding, MHC* (May 28, 1997).

¹¹ See also *Northwest Bancorp, MHC*, 80 Fed. Res. Bull. 1131 (1994) (requiring prior approval and establishment of a restricted capital account for cumulative waived dividends).

2. The Board should extend the 10-year vote mechanism to BHC MHCs

The proposed rule's 10-year member vote requirement for non-legacy waiver SLHCs provides a sound, well-calibrated mechanism for addressing the very conflict of interest that the Board identified in *Greater Delaware Valley*. The same potential conflict – overlapping boards, stockholdings, and the conflict-of-interest considerations of the waiver decision – exists in BHC MHCs just as it does in SLHC MHCs. There is no principled basis for treating BHC MHCs differently from SLHC MHCs with respect to dividend waivers, and the Board should apply the same 10-year vote framework to BHC MHCs.

Extending the 10-year vote framework to BHC MHCs would resolve the conflict identified in *Greater Delaware Valley* in a manner consistent with the Board's broader modernization of Regulation MM. *Greater Delaware Valley* did not prohibit mutual holding companies from waiving dividends. The Board denied Greater Delaware Valley's waiver request in 1997 because it concluded that the tax rationale alone was insufficient to override conflict concerns in the absence of adequate safeguards. The proposed 10-year vote mechanism, coupled with the fiduciary determination requirement and the Board's non-objection authority, provides precisely the safeguards that were absent in *Greater Delaware Valley*. By applying these safeguards uniformly to BHC MHCs, the Board would achieve the regulatory parity that the modernization of Regulation MM is designed to promote. The proposed rule's 10-year vote mechanism represents a well-calibrated standard that should apply equally to all MHCs, regardless of charter type.

Accordingly, we respectfully urge the Board to incorporate the 10-year member vote requirement for BHC dividend waivers (including the exclusion of waived dividends in second-step conversions as noted above) along with the other procedural safeguards in the proposed rule for non-legacy waiver MHCs to address the conflict-of-interest issues that the Board identified in *Greater Delaware Valley*.

IV. Benefit Plans in Mutual-to-Stock Conversions and Mutual Holding Company Offerings

We express our general support for the Board's proposed amendments to 12 CFR §239.63 and 12 CFR §239.25 intended to simplify and streamline the numerous requirements relating to the ability of an MHC and its subsidiary stock holding company to offer stock benefit plans to employees following a mutual-to-stock conversion or a mutual holding company offering. However, we believe that certain aspects of the amendments in their current proposed form would be more restrictive than the current rules with respect to establishing stock benefit plans for employees and should be revised to allow MHCs and converting MHCs to remain competitive with other public companies when establishing stock-based benefits.

A. Limits on Stock Plans Following Mutual-to-Stock Conversions

Under the current version of 12 CFR §239.63 with respect to stock benefits plans initiated in the first year following a mutual-to-stock conversion, the number of shares that may be granted under management recognition plans ("MRPs" or "restricted stock plans") is limited to 4% of the shares (assuming a stock holding company has tangible capital of 10% or more)

issued in the conversion, and the number of shares that may be granted under stock option plans is limited to 10% of the stock issued in the conversion. In addition, MRPs plus employee stock ownership plans (“ESOPs”) are limited to an aggregate of 12% of the shares issued in the conversion, provided that a stock holding company has tangible capital of 10% or more (otherwise the combined limit is 10%).

The practical effect of the current limits generally result in a stock holding company establishing an MRP authorized to issue up to 4% of the shares issued in the conversion, a stock option plan authorized to issue up to 10% of the shares issued in the conversion, and an ESOP which is funded with up to 8% of the shares issued in the conversion. In the aggregate, this permits a stock holding company to offer up to 22% of the shares issued in the conversion to employees through its stock benefits plans, including an MRP, stock option plan, and ESOP.

Under the proposed regulations, 12 CFR. §239.63 would be amended to eliminate the separate limits for MRPs, stock option plans and ESOPs, and a new subsection 12 CFR § 239.63(a)(1)(ii) would impose a potentially stricter limit on all stock benefits plans in the aggregate, as follows:

(ii) The aggregate holdings of any stock benefit plan, employee stock ownership plan, stock option, and management recognition plan do exceed more than fifteen percent of the number of shares that the resulting stock holding company issued in the conversion.

It is important to distinguish ESOPs from MRPs and stock option plans and they should not be considered as equivalent stock benefits. An ESOP is a tax-qualified, trust-based employee benefit plan designed to hold employer stock for employee participants and governed by the specialized requirements applicable to ERISA and Internal Revenue Code qualified plans. Stock options and MRPs, by contrast, are not themselves trust arrangements or separate tax-qualified plan entities. Instead, they are equity compensation devices that may be granted under board- or committee-administered incentive plans, often to both employees and non-employee directors, and are typically subject to exercise prices, vesting schedules, performance conditions, or forfeiture restrictions. ESOPs usually purchase stock in mutual-to-stock conversions while separate stock benefit plans may reserve (but, as described below, not actually hold, through a trust or otherwise) shares for future issuance as compensatory awards to officers, directors, and employees. Accordingly, it is not appropriate to institute one aggregate threshold to distinct categories of stock-based benefits.

Stock holding companies use stock benefit plans to attract, retain, and incentivize talented employees. We believe that the overall limitations under the current rules struck the appropriate balance for recruitment and retention purposes without being overly excessive. Stockholders of companies have overwhelmingly approved MRPs and stock option plans since Regulation MM was implemented and under the predecessor OTS regulations. If this 15% limit is imposed, it would dramatically reduce a stock holding company’s ability to use its stock effectively to attract, retain, and incentivize its employees through the stock holding company’s employee benefit plans (i.e., the limit reduces that aggregate number of shares available under the current regulations by 7% (from 22% to 15%)).

In addition, the use of the phrase “aggregate holdings of any stock benefit plan” is overly broad and potentially even more restrictive. Typically, only the ESOP, which must retain plan assets in a trust, would “hold” shares that are either purchased in the conversion (in the related stock offering) or on the open market following the conversion. MRPs and stock option plans do not “hold” stock, but rather authorize a company to issue shares, generally from the company’s authorized but unissued shares.

B. Recommendations For Limits on Stock Plans Following Mutual-to-Stock Conversions

Due to the differing characteristics of ESOPs as compared to MRPs and stock option plans, we believe separate limits are appropriate and should not be more restrictive than the current regulations. We recommend that ESOPs should be limited to 8% of the shares issued in the conversion, while the aggregate limit for MRPs and stock option plans should be 14% of the shares issued in the conversion. This preserves the same advantages under the current regulations and provides additional flexibility for companies choosing between issuing stock options and MRPs. In addition, we suggest either deleting the term “aggregate holdings of any stock benefit plan” or alternatively limiting that reference to only ESOPs.

C. Limits on Stock Plans Following Mutual Holding Company Offerings

Under the current version of 12 CFR §239.25, the number of shares that may be granted under MRPs is limited to 1.96% of the shares (assuming a stock holding company has tangible capital of 10% or more) outstanding following the MHC minority offering, and the number of shares that may be granted under stock option plans is limited to 4.9% of the shares outstanding following the MHC minority offering. In addition, MRPs plus ESOPs are limited to an aggregate of 5.88% of the shares outstanding following the MHC minority offering, provided that a stock holding company has tangible capital of 10% or more (otherwise the combined limit is 4.9%).

The practical effect of the current limits generally result in a stock holding company establishing an MRP authorized to issue up to 1.96% of the shares outstanding following the MHC minority offering, a stock option plan authorized to issue up to 4.9% of the shares outstanding following the MHC minority offering, and an ESOP which is funded with up to 3.92% of the shares outstanding following the MHC minority offering. In the aggregate, this permits a stock holding company to offer up to 10.78% of the shares outstanding following the MHC minority offering to employees through its stock benefits plans, including an MRP, stock option plan, and ESOP. These are the same percentages for plans in a full conversion offering, multiplied by 49% (the maximum amount of stock that can be sold in a minority offering).

Under the proposed regulations, 12 CFR §239.25 would be amended to eliminate the separate limits for MRPs, stock option plans and ESOPs, and new subsections 12 CFR § 239.25(a)(3) and 12 CFR § 239.25(a)(4) would provide the following:

(3) Provide that all stock benefit plans, employee stock ownership plans, stock option plans, or management recognition plans may not, at any given time, hold in the aggregate more than either 4.9 percent of the outstanding shares of the

subsidiary holding company's common stock or 4.9 percent of the subsidiary holding company's stockholders' equity;

(4) Provided that, following the completion of the proposed issuance, the amount of stock authorized to be issued or acquired by all stock benefit plans, employee stock ownership plans, stock option plans, or management recognition plans may not exceed, in the aggregate, 25 percent of the outstanding shares of the subsidiary stock holding company's common stock or 25 percent of the subsidiary holding company's stockholder's equity.

It is not clear to us how these two sections are intended to interact. As we described above, due to the significant differences between ESOPs as compared to MRPs and stock option plans, we believe separate limits are appropriate and should not be more restrictive than the current regulations. In addition, we repeat our concern stated above with respect to the use of the terms "hold" in subsection 239.25(a)(3) or "issued or acquired" in proposed subsection 239.25(a)(4) unless applied specifically to an ESOP.

The proposed new rule also may limit or eliminate a viable pathway to a second-generation equity plan for institutions in the MHC structure. If institutions in the MHC structure cannot provide a second-generation equity plan, it would severely limit the long-term utility of the MHC structure. Under the current regulations, a subsidiary holding company, with Board approval, can establish a second-generation plan with shares repurchased in the secondary market.

D. Recommendations For Limits on Stock Plans Following Mutual Holding Company Offerings

As stated above, due to the differing characteristics of ESOPs as compared to MRPs and stock option plans, we believe separate limits are appropriate and should not be more restrictive than the current regulations. We recommend that ESOPs should be limited to 3.92% of the shares outstanding following the MHC minority offering, while the aggregate limit for MRPs and stock option plans should be 6.86% of the shares outstanding following the MHC minority offering. This preserves the same advantages under the current regulations and provides additional flexibility for companies choosing between issuing stock options and MRPs. In addition, we suggest deleting the terms "hold" in subsection 239.25(a)(3) or "issued or acquired" in proposed subsection 239.25(a)(4) unless applied specifically to an ESOP.

We also recommend the Board clarify the process for the implementation of a second-generation equity plan and preserve the current exception under 12 CFR §239.25(a)(8)(ii) which allows a second-generation equity plan to exceed the limits placed on stock benefit plans provided that the plan is funded with shares purchased on the secondary market at any time following the completion of the MHC minority offering.

V. Membership Voting

We respond to the Board's specific question on "running proxies" as follows.

Question 20: What are the advantages and disadvantages of the Board's existing limitations around the use of running proxies?

Currently, Section 239.10(a)(4) provides that "running proxies or similar proxies may not be used to vote for a mutual holding company reorganization, mutual-to-stock conversion undertaken by a mutual holding company, dividend waiver, or any other material transaction." Section 239.10 also sets forth the requirements for the solicitation of proxies in general, including requirements as to any required disclosure, form of the proxy and duration. It is standard practice for most MHCs and mutual banks to present a form of "running" proxy for optional execution by a customer/member when the customer/member opens a deposit account, which the customer/member has the option to sign or not to sign. These running proxies must meet the prescribed requirements set forth in Section 239.57(b), including minimum font size and a statement within the proxy that it is revokable at any time by the customer. The form of proxy typically notes that such revocation can be effected by a later dated proxy, execution of a ballot at a member meeting, voting in person at a member meeting or other written notice of revocation delivered to the secretary of the institution. Accordingly, the ability of a customer/member to revoke a running proxy is uncomplicated and readily available through multiple measures.

Based on our and other advisors' observations of the voting history and habits of mutual members, the substantial majority of mutual members never vote in person at an annual meeting of members to elect directors, nor do they vote by a later-dated proxy or ballot. Based on our and other advisors' observations, the only time when mutual members actually attend a meeting or vote by proxy (not a running proxy) is in the context of a conversion, mutual holding company reorganization or dividend waiver vote - all of which prohibit the utilization of voting by running proxy. These prohibitions on the use of running proxies appear to be founded on the policy that members should have the ability to exercise their voice on material matters. In this regard, the regulatory authorities have deemed the annual election of directors to be an event that is not material enough to warrant the prohibition on running proxies - when such matters appear exceedingly material, since directors make the decisions to convert, reorganize or merge. The delineation being drawn as to the use of running proxies for these annual matters versus a conversion, reorganization or merger seems arbitrary given that rights of members as to running proxies are clearly defined and they are easily revocable. Moreover, detailed proxy statement disclosures that must meet regulatory requirements are reviewed by the regulatory authorities for content and compliance and are delivered to all voting members well in advance of the meeting to vote on the conversion, reorganization or dividend waiver. Accordingly, if there is detailed disclosure about the transaction and the rights of members, including that their running proxies are easily revocable (both when an account is opened and in disclosure relating to a specific transaction), there appears to be no valid policy reason to treat the vote on a conversion, reorganization or dividend waiver differently.

When you consider that when members are asked to vote on a matter: (1) members generally do not vote unless prompted many times (usually this takes 35 to 40 days with several expensive paper mailings with a cost of several tens of thousands of dollars), (2) when members do vote, they overwhelmingly vote to approve the transaction (typically 85% to 97% of those

actually returning a proxy¹², and (3) it is extremely difficult to get at least 50% of the votes eligible to be cast to vote by proxy; accordingly, it appears arbitrary and questionable as to why running proxies should be impermissible for a vote on a conversion, reorganization or dividend waiver.

One recommended solution to mitigate this policy situation would be to keep the current system of requiring the approval standard of a majority of votes eligible to be cast for full conversions and MHC reorganizations, as well as the existing disclosure requirements, but allow the utilization of running proxies. In this regard, no corporate democracy is lost as members can still vote by voting in person at the meeting or by executing the new proxy, which automatically revokes the running proxy, and an institution is not having to bear the brunt of the use of unnecessary resources and time to solicit those members that are apathetic about their voting rights.

VI. Other Technical Aspects

A. Model Charter

While we recognize the utility of the retention of model charters and Bylaws for MHCs and their subsidiary holding companies, and appreciate the proposed ability for companies to deviate from those documents, we note that the OCC recently revised its regulations to no longer require regulatory notice when an entity adopts bylaw amendments that comply with the model bylaws. See 12 C.F.R. §5.22(j)(3)(iii) and 12 C.F.R. §5.22(j)(2)(iii). A similar provision for an MHC and a subsidiary holding company would save considerable time and legal expense, as (i) there would seem to be limited regulatory purpose to a regulatory submission to be made to adopt a provision already deemed acceptable by the Board, and (2) we believe that the most frequent bylaw amendment for an MHC or a subsidiary holding company is merely revising the number of members of a board of directors through a bylaw amendment, and there is no regulatory purpose to a regulatory submission of that type. Accordingly, we recommend that an MHC and a subsidiary holding company be permitted to amend its bylaws without regulatory notice.

12 C.F.R. §239.16(c)(1)(iii) would be amended by striking “and filed with Board within 30 days of adoption,” as follows:

(iii) For purposes of this paragraph (c), bylaw provisions that adopt the language of the model bylaws contained in appendix C to this part, if adopted without change, ~~and filed with Board within 30 days after adoption~~, are effective upon adoption. The Board may amend the model bylaws provided in appendix C to this part.

¹² If requested by the Board, we will provide detailed, historical voting results by members with respect to any or all types of transactions for which member approval is required.

Similarly, 12 C.F.R. §239.23(b)(1)(iii) would be amended by striking “and filed with Board within 30 days after adoption,” as follows:

(iii) For purposes of this paragraph (b), bylaw provisions that adopt the language of the model bylaws contained in appendix D to this part, if adopted without change ~~and filed with Board within 30 days after adoption~~, are effective upon adoption. The Board may amend the model bylaws provided in appendix D.

B. Mailing of Notice

The notice provision for meetings of members for MHCs contained in 12 C.F.R. §239.15(b)(3) provides that notice shall be sent no more than 45 prior to the date of the member’s meeting. However, the similar notice provision for a meeting of stockholders of a subsidiary holding company is 50 days. It seems incongruous that a subsidiary holding company should have more time to solicit stockholders for a meeting than an MHC, especially given the difficulty in obtaining member approval for transactions as compared to stockholder approval. Accordingly, we recommend that the notice provision for MHC member meetings be extended to match that for a subsidiary holding company.

12 C.F.R. §239.15(b)(3) would be amended by replacing “45” with “50” as follows:

Notice of meeting of members. Notice specifying the date, time, and place of the annual or any special meeting and adequately describing any business to be conducted shall be published for two successive weeks immediately prior to the week in which such meeting shall convene in a newspaper of general circulation in the city or county in which the principal place of business of the subsidiary savings association is located, or mailed postage prepaid at least 15 days and not more than ~~45~~ 50 days prior to the date on which such meeting shall convene to each of its members of record at the last address appearing on the books of the mutual holding company. A similar notice shall be posted in a conspicuous place in each of the offices of the subsidiary savings association during the 14 days immediately preceding the date on which such meeting shall convene. The bylaws may permit a member to waive in writing any right to receive personal delivery of the notice. When any meeting is adjourned for 30 days or more, notice of the adjournment and reconvening of the meeting shall be given as in the case of the original meeting.

C. Running Proxies

Under 12 C.F.R. §239.10(a)(iv), an MHC may use “running” proxies at a member meeting, “provided that the member granting such proxy has been furnished a proxy statement regarding the matters ...” This conflicts with 12 C.F.R. §239.15(b)(3), which permits notice of a meeting to be provided solely by newspaper notice, and does not require a mailing of a proxy statement. We propose that “running” proxies be permitted for any member meeting for which proper notice is provided.

12 C.F.R. §239.10(a)(iv) would be amended to remove the requirement for the mailing of a proxy statement, as follows:

(4) *Use of “running” proxies.* Unless otherwise prohibited, a mutual holding company may make use of any proxy conferring general authority to vote on any and all matters at any meeting of members, provided that ~~the member granting such proxy has been furnished a proxy statement regarding the matters and~~ the member does not grant a later-dated proxy to vote at the meeting at which the matter will be considered or attend such meeting and vote in person, and further provided that “running” proxies or similar proxies may not be used to vote for a mutual holding company reorganization, mutual-to-stock conversion undertaken by a mutual holding company, dividend waiver, or any other material transaction. Subject to the limitations set forth in this paragraph, any proxy conferring on the board of directors or officers of a mutual savings association general authority to cast a member's votes on any and all matters presented to the members shall be deemed to cover the member's votes as a member of the mutual holding company and such authority shall be conferred on the board of directors or officers of a mutual holding company.

D. One-Year Post-Conversion Sale Restrictions

Under 12 C.F.R. §239.63(b)(1), following the completion of a conversion to stock form of an MHC, insiders generally cannot sell stock purchased in the related offering for one year following the completion of the date of purchase. However, under 12 C.F.R. §239.25(a)(15), applicable to an MHC in a minority stock offering, includes “associates” of insiders as also subject to this restriction. It would seem to disadvantage a company that conducts an MHC offering to restrict individuals who do not work for the MHC or its subsidiaries or who are not involved in the decision to conduct an offering, when such individuals would not be restricted in a full conversion to stock form. We propose that individual purchasers be treated equally in each type of offering.

12 C.F.R. §239.25(a)(15) would be amended to remove the restriction on associates, as follows:

(15) Provide that stock purchased by insiders of the subsidiary holding company and subsidiary savings association ~~and their associates~~ in the proposed issuance shall not be sold for a period of at least one year following the date of purchase, except in the case of death of the insider ~~or associate~~;

E. Community Offering 2% Allocation Provision

In a subscription offering for each of a conversion by an MHC as well as an offering by a subsidiary holding company, an eligible account holder, supplemental eligible account holder or other member is entitled to a maximum level of subscription rights, as set forth in the applicable offering sections. Such amount is to equal the purchase limitation established for a community offering and/or a public offering under 12 C.F.R. §239.59(p). However, we note that 12 C.F.R.

§239.59(p) does not actually provide a mechanism for a purchase limitation to be established. In addition, 12 C.F.R. §239.59(p)(2) further provides orders in a community offering or a public offering must be filled up to “a maximum of two percent of the conversion stock ...” As a result, an individual submitting an order in a community offering could be entitled to receive more stock than would be permitted for an individual with actual subscription rights, assuming that an individual maximum level of subscription rights is established below 2% of the stock being sold. Furthermore, 12 C.F.R. §239.59(p)(1) already provides that the method of selling stock in a community offering or a public offering must be “to achieve a widespread distribution of the stock.” Not only is this concept repeated in 12 C.F.R. §239.59(p)(2) (“on a basis that will promote a widespread distribution of stock”), but we believe that required orders to be filled up to an amount that could be higher than the existing maximum purchase limitation has the direct opposite effect of encouraging a widespread distribution of stock.

We propose that the concept of a 2% order maximum be replaced with a specific purchase limitation, which would match that provided for in the subscription offering, as follows, and be revised to remove duplicative language, as follows:

(p) *Conditions on community offerings and public offerings.*

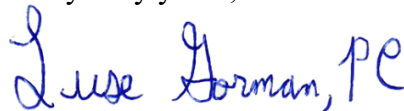
(1) If the mutual holding company offers conversion shares in a community offering, a public offering, or both, it must offer and sell the stock to achieve a widespread distribution of the stock.

(2) If the mutual holding company offers shares in a community offering, a public offering, or both, it must establish a maximum purchase order consistent with paragraph (n) of this section. If the mutual holding company receives more orders for shares than are available for sale in a community offering or a public offering, first fill orders for the stock up to a maximum of two percent of the conversion stock on a basis that will promote a widespread distribution of stock. ~~The~~ the mutual holding company must allocate any remaining shares on an equal number of shares per order basis until it fills all orders.

* * *

Thank you for your consideration of the matters addressed in this comment letter. Should any representatives of the Board have any questions or comments, please do not hesitate to contact Lawrence M.F. Spaccasi at (202) 274-2037, Benjamin Azoff at (202) 274-2010 or Zachary Davis at (202) 274-2021.

Very truly yours,



Luse Gorman, PC