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INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

November 7, 2000

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: Dockets No. 2000-57 & No. 2000-56

Re: 12 CFR Parts 563b and 575, Mutual Savings Associations, Mutual Holding Company Reorganizations, and Conversions From Mutual to Stock Form *and* Repurchases of Stock by Recently Converted Savings Associations, Mutual Holding Company Dividend Waivers and Gramm-Leach-Bliley Changes

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the efforts being made by the Office of Thrift Supervision (OTS) to eliminate disparities in regulations that appear to favor one form of savings association ownership over another. Responding to comments that current rules favor the stock form of ownership, the OTS has proposed rules and issued interim final rules designed to better enable mutual institutions to maintain the mutual structure, as well as making the mutual holding company (MHC) structure a more appealing alternative to full conversion. Separate from these rulemaking efforts, the agency is revising the examination procedures for mutual institutions to make examinations more comparable to those for other thrifts.

Mutual Holding Companies

There are currently 422 OTS-regulated mutual savings institutions (nearly 40 percent of all OTS-regulated thrifts). According to the agency, these "tend to be

[1] ICBA is the primary voice for the nation's community banks, representing 5,300 institutions at over 16,900 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA's members hold more than $486 billion in insured deposits, $592 billion in assets and more than $355 billion in loans for consumers, small businesses and farms. They employ over 239,000 citizens in the communities they serve.

community-based, community-focused institutions whose sole purpose is to provide a safe place for community members to save, and to invest those savings back into the community through prudent credit programs." However, the agency also believes that the community focus tends to be lost when the institution converts to a stock form of ownership and management must respond to stockholder interests. We do not share this OTS bias, believing there are thousands of stock-held community institutions successfully serving local communities.

The OTS is taking steps to ensure that a mutual institution considers alternatives before electing conversion. For example, the agency notes alternative mechanisms short of conversion that a thrift may use to raise capital, such as mutual capital certificates, subordinated debt, trust preferred securities, or real estate investment trusts (REITs). However, it is important to recognize that some of these mechanisms may not be practical for smaller mutual institutions, especially those located in rural areas. Therefore, for these institutions, conversion may be the easiest solution to a need to raise capital.

To create a viable alternative to full conversion, the proposal is designed to make the mutual holding company (MHC) more appealing, especially since the OTS believes the MHC structure can preserve the attributes of mutuality while providing enhanced opportunities to raise capital. Instead of full conversion to stock ownership, the proposal encourages consideration of limited conversion to a stock institution wholly owned by a MHC. The OTS suggests this may be especially appropriate if the mutual has no immediate plans to deploy capital raised in the conversion. To ensure that a mutual considering conversion considers all options, the proposal would require thrift officials to meet with the OTS Regional Director to discuss a conversion proposal before a full mutual to stock conversion application is filed.

One way that the OTS proposes to make the MHC structure more attractive is to make it similar to financial holding companies (FHCs) by authorizing more expansive powers for MHCs, e.g., the ability to engage in securities underwriting and insurance underwriting activities. The ICBA believes this is a step in the right direction and agrees this will make the MHC structure more appealing. Any steps to make the MHC form of ownership more appealing are positive changes. It is important that financial institution management have available as many options as possible for the institution's corporate structure. The Gramm-Leach-Bliley Act clearly recognized this by expanding the structural opportunities available. Such flexibility is especially critical with the dynamic changes that are taking place in today's financial markets. The ICBA supports steps by regulators to ensure management has different corporate structures available to accomplish business strategies, consistent with safe and sound operation.

While the initial decision to convert is logically made by management, the ICBA also believes the conversion should be supported by the members through a vote of the members. Some commenters have suggested that this can be an expensive proposition that may discourage the formation of mutual holding companies as an intermediate step to full conversion. However, to address these concerns, the OTS might develop a short form proxy solicitation that would reduce costs while ensuring membership support exists for the conversion.

Dividend Waivers. In a separate proposal, the OTS is revising the rules on dividend waivers. In the past, the OTS required an MHC to reduce the number of shares minority shareholders received in exchange for shares in the fully converted company by any previously waived dividends. This caused a dilution of shares for the minority shareholders. The OTS believes this may have caused a number of companies to fully convert to stock form rather than maintaining the MHC structure. Therefore, they are eliminating this procedure. The ICBA believes this will be helpful.

The ICBA also supports permitting mutual institutions to affiliate with other mutuals "to leverage managerial and administrative resources" and the ability of MHCs to use stock to make acquisitions. Both these steps will permit MHCs flexibility and will offer management a broader range of options in day-to-day operations. The ICBA encourages the OTS to continue to explore means to offer MHCs greater flexibility in operations while reducing regulatory burden.

Reorganizations and Stock Conversions

According to the OTS, the proposed rules are designed to ensure that a mutual institution's board of directors considers all implications of a conversion for the management and operations of the institution, as well as considering alternatives to a full conversion. Therefore, the proposal would require the mutual to develop a business plan and then meet with the OTS Regional Director to discuss the business plan. For the conversion to proceed, the Regional Director must not object to the conversion plan.

This pre-conversion meeting with the OTS Regional Director is a new requirement. For a business plan to be acceptable to the Regional Director, the proposal would require that it must:

- Clearly and completely describe projected operations for three years following conversion
- Demonstrate how conversion proceeds will help meet the credit and lending needs in the thrift's proposed market
- Demonstrate a need for new capital
- Describe experience with similar initiatives
- Describe risks associated with the plan
- Demonstrate that management and the board of directors have the necessary expertise
- Demonstrate that the thrift will achieve a reasonable return on equity

Overall, the proposal is designed to ensure the business plan fully supports the business objectives for the conversion. Before being submitted to the OTS, the business plan must be approved by two-thirds of the institution's board of directors. Under the proposal, the OTS may require a thrift to delete or revise any provision in the plan if OTS determines the provision is inequitable, is detrimental to the thrift, account holders, other thrifts or is contrary to public policy.

While the ICBA supports the concept of a business plan, we also believe that the specificity and detail required may be unduly burdensome and may be viewed as a barrier to conversion. We support the concept of meeting with the OTS Regional Director to discuss the business plan and believe this step will help ensure that management has carefully considered the ramifications of a conversion. However, the detail required may effectively discourage mutuals from pursuing a conversion to a mutual holding company or to a stock form of ownership. This reduces the flexibility that management should have in today's environment. The ICBA believes this can be easily rectified. Instead of mandating each one of these steps as pre-requisites, the final rule can outline the same requirements as elements that *should* be addressed in a business plan, *when appropriate*. In other words, the steps listed serve as an outline of the elements that a mutual's board should address in evaluating the conversion process, but if each and every item is not addressed in a business plan, that should not be a fatal flaw. There may be facts and circumstances that would support a conversion where the mutual may not be able to meet all the listed requirements, but that alone should not be a barrier to conversion, especially if the conversion is otherwise an appropriate step supported by the management and directors of the institution. The meeting with the OTS Regional Director should function more as a consultation to help guide the institution as it considers a conversion, not a hurdle to overcome. It is important that the OTS ensures that a converted institution will operate in a safe-and-sound manner, but regulations or requirements that go beyond that can result in the agency unnecessarily removing management discretion and authority from the institution and substituting agency judgment in its place.

The ICBA does, however, support certain elements as appropriate items for consideration. For example, demonstrating how the proceeds of the conversion will be used to meet the credit needs of the community should be considered. The ICBA also believes that it is appropriate for the OTS Regional Director to approve the plan, since the regional office is much more likely to be familiar with local conditions and economic factors than national headquarters. However, the final goal should be whether the conversion has been carefully considered and planned. The ICBA also believes that the business plan should be allowed to incorporate contingencies for stock repurchases following conversion to allow the thrift to take advantage of market dynamics when appropriate.

Once the Regional Director has approved the conversion plan,[2] the members of the mutual institution must be promptly notified of the conversion by mail and a majority of the members eligible to vote must then approve the plan. At the time it approves the conversion plan, the OTS will also review any proxy solicitation materials for approval, but

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[2] Although the proposal suggests that the Regional Director must not object to the plan in order to move forward, the practical ramification is that the Regional Director must approve the plan. It would make more sense for the final rule to acknowledge that Regional Director approval of the business plan is a pre-requisite to proceeding with a conversion.

noone may imply that the OTS either endorses the conversion or has determined that the proxy material is accurate and not false or misleading.

Distribution of Stock

Conversion shares must first be offered to eligible account holders, tax-qualified employee stock ownership plans, supplemental eligible account holders, other voting members with subscription rights, and the community and the general public (in that order). The ICBA believes that the proposal establishes the correct priorities for distribution of stock. We also agree that demand deposit account holders and savings account holders should be treated the same in prioritization of classes of individuals eligible to purchase shares. However, we also encourage the OTS to include borrowers of the institution within the priority list just behind depositors and officers and directors; while the interest of borrowers is not on the same level as those of depositors, borrowers are still customers of the institution and often have greater interest in the viability of the converted institution than members of the general public.

When filling subscription orders, the thrift *may* give preference to those residing in the local community, but sales to the general public *must* give preference to local residents. The ICBA finds it appropriate to give preference to local residents.

Officers, directors and their associates are eligible to receive subscription rights, but the total amount of stock that officers and directors can purchase is limited, with the limitation based on the asset size of the institution (ranging from high of 35 percent for a thrift that is $50 million or less down to 25 percent for an institution that is over $500 million). The ICBA agrees it is appropriate to limit the amount of stock that insiders may purchase.

Benefit Plans

A stock option, management or employee stock benefit plan may be adopted within 12 months following the conversion. However, the plan must be disclosed in the conversion proxy statement and stock offering circular. The offering circular must also indicate that there will be a vote on the plan(s). Shareholders must approve any plan by a vote of the majority of those eligible. The meeting to approve any of these plans may not be held until at least six months after the conversion.

Stock options under a stock option plan may not exceed 10 percent of the stock issued in the conversion. Generally, management stock plans may not hold an aggregate of more than three percent of the conversion stock, while tax-qualified employee plans and management stock benefit plans are limited to a total of 10 percent of stock issued in the conversion. No one individual can receive more than 25 percent of the shares under any plan. Stock issued at conversion cannot be used to fund management or employee stock benefit plans. Interest under these plans cannot vest earlier than one year after the plan has been approved, and it cannot vest more quickly than 20 percent annually. However, a benefit plan may provide for accelerated vesting in the even of disability, death or a change in control of the institution. Finally, executive officers and directors must be required to exercise their options under the plan if the thrift becomes critically undercapitalized or is subject to an enforcement action.

The ICBA believes that it is appropriate to allow the adoption of a stock benefit plan within 12 months of conversion, and we also agree with the proposed limits for the amount of stock that can be held in these plans. Attracting qualified management and directors is a continual challenge for financial institutions in a highly competitive marketplace, especially smaller institutions or institutions located in rural areas. Offering them flexibility to craft compensation packages for management and directors, e.g., through the use of stock benefit plans, is important to ensure they attract qualified individuals to lead the institution.

Trading Shares After Conversion

Directors, officers and their associates may not sell conversion shares for the first year after conversion (in the event of death, the officer or director's successor in interest may sell the shares). For three years following the conversion, officers, directors and their associates may only purchase stock through a registered broker/dealer. The ICBA supports this revision.

The thrift generally may not repurchase shares for the first year following the conversion. However, open market purchases up to five percent may be made following notice to the OTS if the repurchase does not reduce regulatory capital below the amount needed for the liquidation account. After the first year, stock may be repurchased. This is a change from existing procedures, which restrict repurchases during the first three years following conversion. The OTS is making it easier to repurchase shares, based on waivers the agency has routinely granted. However, in order to repurchase shares during the first year, the thrift must specify the extraordinary circumstances warranting such repurchase program and must detail the impact the repurchase will have on capital.

Eliminating restrictions on stock repurchases after the first year following conversion to bring OTS rules into line with other agencies is a step that ICBA supports. Uniform regulations help alleviate confusion and thereby reduce regulatory burden. The ICBA also believes it is useful to include provisions in the final rule that allow exceptions to the general ban on repurchase during the first year. In a very dynamic financial marketplace, it is important to have options for financial institutions, including the ability to repurchase stock.

Charitable Organizations

The proposal sets forth specific standards and procedures for forming charitable organizations and contributing stock to the new charity or to an existing charity as part of the conversion process. Essentially, the proposal codifies existing OTS practice.

Conversion shares may be contributed to a charitable organization provided the conversion plan provides for the contribution and the organization is qualified as tax-exempt. The charitable organization must be established to serve or make grants in the local community. For at least five years after the charitable organization is established, at least one seat on the board of the organization must be reserved for a member of the local community and one seat must be reserved for a director of the thrift. Shares held by the charitable organization will be voted in the same ratio as other shares voted by the thrift's shareholders.

The ICBA finds these procedures appropriate.

Thank you for the opportunity to comment. Should you need additional information or further clarification on any of the items addressed, please contact Robert Rowe, ICBA's Regulatory Counsel at 202-659-8111.

Sincerely,

Thomas J. Sheehan
President