

OTS Proposes New Rules to Simplify and Clarify MHC Stock Benefit Plans

The Office of Thrift Supervision (“OTS”), the federal banking agency that charters and regulates federal savings banks/savings associations and mutual holding companies (“MHCs”), has proposed amendments to its regulations to clarify and simplify the rules relating to MHC stock benefit plans.

If adopted, the OTS proposal would eliminate much of the confusion associated with stock benefit plans under the OTS’ current MHC regulations. Moreover, the proposed rules would provide MHCs with additional protection against activist shareholders who attempt to assert undue influence over the adoption of stock benefit plans by MHCs. The proposed rules primarily address stock option plans (which give officers and directors the right to purchase stock at a designated price over a fixed period of time) and stock award plans (which grant stock to officers and directors and are often referred to as management recognition plans (“MRPs”).

This is an important proposal and we strongly encourage all MHCs and mutual savings banks and associations, whether state or federally chartered, to submit comments in support of the proposed rules. Comments are due by September 18, 2006.

Executive Summary

The proposed rules would:

- Eliminate the need for a separate vote of minority stockholders for stock benefit plans adopted more than one year after an MHC minority stock offering.
- Confirm that well-capitalized institutions can have an employee stock ownership plan and other tax-qualified plans (collectively, an “ESOP”), a stock option plan, and an MRP for up to 3.92%, 4.9% and 1.96%, respectively, of a savings bank’s (mid-tier holding company’s) *outstanding shares*.
- Confirm that the OTS rules restricting vesting and

award allocations do not apply to stock benefit plans adopted more than one year after an MHC minority stock offering.

Summary of Proposed Rule

Anyone who has read the current OTS regulations regarding MHC stock benefit plans will agree that the current rules are confusing. The OTS intends to eliminate this confusion by amending its regulations to clarify and confirm the following:

- An MRP may acquire up to 1.47% of a savings bank’s *outstanding* common stock as of the completion of a minority stock offering. However, if the savings bank’s tangible capital is at least 10% of assets at the time the MRP is implemented, the MRP may acquire up to 1.96% of a savings bank’s *outstanding* common stock.
- An ESOP and an MRP may acquire in the aggregate up to 4.9% of a savings bank’s *outstanding* common stock (calculated as of the completion of a minority stock offering), unless the savings bank’s tangible capital is at least 10% of assets at the completion of the offering, in which case the ESOP and MRP may acquire in the aggregate up to 5.88% of a savings bank’s *outstanding* common stock.
- Stock option plans may grant options for up to 4.9% of a savings bank’s *outstanding* common stock as of the completion of a minority stock offering.
- Restrictions on the *aggregate amount* of common stock that may be granted under stock option plans and MRPs or acquired by insiders and their associates *do not include shares acquired by plans or insiders in the secondary market* provided that, in the case of stock plans, such secondary market purchases occur no sooner than one year after a minority stock offering.

- The current OTS restrictions with respect to maximum awards to individual officers and directors and directors as a group, vesting and necessary stockholder approvals *do not apply to plans adopted more than one year after a minority stock offering*, provided proxy materials soliciting a vote on the plans are not distributed sooner than 12 months after the offering.
- No separate vote of minority stockholders is necessary to approve stock benefit plans adopted *more than one year* after a minority stock offering. A *majority of the voting minority shares* must approve plans adopted within one year of the completion of a stock offering.
- The *minimum* purchase limitation would be reduced from 1% to 0.1% of a stock offering.

Analysis

If adopted, the proposal would clarify OTS rules relating to MHC stock benefit plans, and eliminate much uncertainty and expense that savings banks have faced in recent years with respect to implementing such plans. The proposed rules confirm that:

Size of Stock Plans. An ESOP, stock option plans and MRP plans can be for up to 3.92%, 4.9% and 1.96%, respectively, of a savings bank's *outstanding* common stock, regardless of the percentage of a savings bank's stock sold in a minority stock offering (so long as the MRP and option plans together do not exceed 25% of the *outstanding minority shares*). Total stock benefit plan awards could be larger than the foregoing amounts, provided awards in excess of the above limits are funded by stock purchases in the secondary market. These amounts translate into awards in excess of 8%, 10% and 4%, respectively, of a minority stock offering, and are intended to confirm the OTS' policy that well-capitalized institutions should not be required to raise more capital than necessary solely to fund larger stock benefit plans, which historically have been based on the size of a stock offering.

Restrictions On Stock Plans After One Year. The OTS restrictions on vesting and award allocations to officers and directors under current Section

563b.500(a)(4)-(14) would not apply to plans adopted *more than one year after* a minority stock offering. This proposal is intended to eliminate OTS oversight over details of stock benefit plans which are more appropriately within the purview of management.

Separate Minority Vote. A separate vote of minority stockholders to approve stock benefit plans would not be required for plans adopted more than one year after a stock offering. Eliminating the need for a separate vote of minority stockholders is consistent with the fundamental premise that the MHC parent is the controlling stockholder of the mid-tier stock holding company or savings bank, and that a separate vote of minority stockholders, in effect, disenfranchises the MHC. Under the OTS standard conversion regulations, no vote of stockholders is required to approve plans implemented after one year, other than the normal vote required by the stock exchanges.

The OTS proposal also will help prevent large activist stockholders from attempting to exercise undue influence over the implementation of stock benefit plans by MHCs. Stockholder activists have tried to exploit the separate minority vote requirement by proposing legislation in Congress to require MHC boards of directors to be elected by minority stockholders only. This legislative effort failed largely through the efforts of the OTS and the thrift industry.

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If you have any questions regarding the OTS proposal, please do not hesitate to contact any of our partners below.

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